UNIVERSIDADE CATÓLICA PORTUGUESA

THE IMPLICATIONS OF CHINA'S ECONOMIC STATECRAFT IN THE EUROPEAN UNION: THE CASE OF CHINESE FOREIGN DIRECT INVESTMENT IN PORTUGAL

Tese apresentada à Universidade Católica Portuguesa para obtenção do grau de doutor em Ciência Política e Relações Internacionais

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Abstract

This thesis contributes to the analysis of Chinese economic statecraft in the European Union, by zooming on the Chinese Outward Foreign Direct Investment (COFDI) in Portugal. Understanding economic statecraft as the usage of economic instruments in pursuit of political objectives, this work investigates the political and strategic implications of COFDI in Portugal. While many regard COFDI as a lifeline, others fear it to be politically motivated and part of a Chinese masterplan to convert economic power into political influence. But what type of political influence can China aspire to acquire, and under what conditions?

This thesis is pioneer in providing an exhaustive library of investment case studies about all COFDI cases in Portugal between 2011 and 2019. It also surfaces how the potential implications of COFDI are perceived by the key domestic stakeholders, such as senior government officials, business executives, representatives from local Chinese institutions and other opinion makers. Zooming in on the investment cases reveals insights regarding the motivations behind COFDI and its operationalization patterns. Chinese investors are willing to have non-controlling stakes in assets which provide other strategic returns, such as access to know-how or to the Portuguese speaking markets. Through the interviews with key stakeholders, it was possible to identify four clusters based on the interviewees perceptions of COFDI, and extract the overall picture - the prevailing approach to COFDI is that of confidence on the country's ability to *have the cake and eat it too*. This means using COFDI as a proxy for domestic capital (which is scarce), balancing it against the dependence from western powers and pulling all parties to invest further in the country, with due awareness about tangible security implications.

Key words: Economic Statecraft, Chinese Outward Foreign Direct Investment (COFDI), China-Portugal relations

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List of Acronyms

AEI	American Enterprise Institute
BRI	Belt Road Initiative
CAI	Comprehensive Agreement on Investment
CC	Central Committee
CCP	Chinese Communist Party
CEE	Central and Eastern European
CFIUS	Committee on Foreign Investment in the United States
CFSP	Common foreign and Security Policy
COFDI	Chinese Outward Foreign Direct Investment
CGIT	China Global Investment Tracker
CPLP	Community of Portuguese Speaking Countries
DV	Dependent Variable
EEC	European Economic Community
EC	European Commission
ECB	European Central Bank
EFTA	European Free Trade Association
EMNE	Emerging Market Multinational Enterprises
EMU	European Monetary Union
EU	European Union
FAC	Central Foreign Affairs Commission
FALSG	Central Foreign Affairs Leading Small Group
FDI	Foreign Direct Investment
FPA	Foreign Policy Analysis
FPI	Foreign Portfolio Investment
GDP	Gross Domestic Product
HK	Hong Kong
HR	Human Rights
IDDS	innovation-driven development strategy
IMF	International Monetary Fund
IPE	International Political Economy
IR	International Relations

IV	Independent Variable
LX	Luxembourg
MAD	Mutually Assured Destruction
MES	Market Economy Status
MLP	medium- to long-term program
MNE	Multinational Enterprises
MOFCOM	(Chinese) Ministry of Commerce
NATO	North Atlantic Treaty Organization
NED	National Endowment for Democracy
NL	The Netherlands
NSLSG	Central National Security Leading Small Group
NZ	New Zealand
OBOR	One Belt, One Road
OECD	Organization for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
PBSC	Standing Committee of the Politburo
PESCO	Permanent Structured Cooperation
PLA	People's Liberation Army
PIP	Political Influence Potential
PR	Public Relations
PRC	People's Republic of China
PSC	Political and Security Committee
PFTZ	Pilot Free-Trade Zones
RE	Real Estate
SAFE	(Chinese) State Administration of Foreign Exchange
SEI	Strategic Emerging Industry
SOE	State Owned Enterprise
SSC	State Security Commission
SWF	Sovereign Wealth Fund
TEU	Treaty of the European Union
TFEU	Treaty on the functioning of the European Union
TSI	Threat to Strategic Interests
TVE	Town and Village Enterprise
UFWD	United Front Work Department

USA	United States of America
UN	United Nations
WB	World Bank
WTO	World Trade Organization

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1. Introduction

1.1. Research object and level of analysis

The research object of this thesis is the *Chinese Outward Foreign Direct Investment (COFDI) in Portugal in 2011-19*, which is a subset of the *Chinese economic statecraft in the European Union (EU)*.

Economic statecraft is understood as the usage of economic instruments in pursuit of political objectives. The list of such economic instruments includes Government bonds, trade policy and FDI, among others. The EU is a supranational construct, a political and economic union of 27 member states, among which Portugal.

This thesis focuses on two levels of analysis: the state and the individual. At the state level, it studies how and why states (e.g., China, Portugal) engage with each other. At the individual level, it focuses on commercial and governmental agents, questioning if and how equity ownership can be used as an instrument of coercion, subversion, or other milder tactics of political influence (e.g., positive strategic engagement). More concretely, if Chinese companies can steer Portuguese economic agents and have political influence over the Portuguese Government. It also looks at other decisions, such as the motivations of COFDI.

This thesis does not focus on the systemic level of analysis, nevertheless provides context to it, and questions how COFDI in the EU impacts the relationship between the current global hegemon (the USA) and its strongest contender. Via the North Atlantic Treaty Organization (NATO), the USA is the ultimate guarantor of territorial integrity and peace in Europe. China is EU's largest trading partner, and both are Eurasian. The EU has been essaying a balancing act between the two superpowers, and so has Portugal. Is that positioning sustainable? Ultimately, the objective of this thesis is to provide a fact-based contribution to the discussion about what can be done by Portugal, and by the EU, to properly deal with COFDI.

1.2. Context

The context to this thesis is organized around four key messages:

1.2.1 The Chinese economic statecraft in Portugal and in the EU goes beyond FDI and is ambivalent from a strategic perspective.

1.2.2 The COFDI in Europe rose sharply until 2017 driven by economic and political factors from both China and the EU. The significant drop since 2018 was politically driven.

1.2.3 Portugal concentrates slightly more COFDI than its fair share in Europe. Its share was higher in the beginning of the decade and decreased gradually.

1.2.4 COFDI is different from Western FDI, and the role played by the state in the Chinese economy makes it unique.

1.2.1 The Chinese economic statecraft in Portugal and in the EU goes beyond FDI and is ambivalent from a strategic perspective.

At first, COFDI was generally welcomed in Portugal and seen as inherent to the good bilateral relationship (Breda, 2015), anchored around the smooth transition of Macau (Mongiardim, 2018). The few voices of concern were expectable in an open society. Both in Portugal and in the EU, from *a pure* economic perspective, the rise of COFDI was non-controversial.

China's accession to the World Trade Organization (WTO) accelerated the trade flows, which are another critical component of the economic relation between China and the EU. This policy change was more polarizing. On the cheering side, many multinational enterprises (MNE) successfully penetrated China's market to the point that half of the Chinese exports to the EU are performed by European MNE (Koopman & Wang, 2016). The Europeans also benefited from low priced Chinese goods which flooded the market. But smaller countries and SME, which cannot succeed in China, have cried out against the collateral erosion of native industries.

Economic statecraft is an old and enduring phenomenon everywhere. Germany allegedly invested in Poland and Russia to gain their support for its reunification (Blackwill & Harris,

2016). China boycotted trade and tourism to South Korea in retaliation to the hosting of an American missile defense system. The USA has ongoing embargoes over Cuba, Iran, North Korea, Syria, Sudan, Venezuela (Treasury, 2018). The EU maintains an arms embargo over China since 1989. . This phenomenon encompasses a broad spectrum of instruments, from economic incentives to instruments of economic warfare.

Judging the Chinese usage of economic statecraft in the EU is tricky for several reasons. First, China's political system is a bureaucratic-authoritarian one-party state, in principle highly centralized but in practice substantially decentralized (Kroeber, 2016), which differs from the Western liberal democracy. In the context of 2003's *Strategic Partnership* with China, the EU has voiced concerns, particularly about state control over the economy and the different view on human rights (HR). The EU itself uses economic instruments such as the arms embargo or the denial of Market Economy Status (MES) at the WTO to push reform in China; therefore, the EU also applies economic statecraft in dealing with China.

Second, the EU member states transferred sovereignty over trade and investment policy to the EU. In 2020, the EU and China concluded in principle a Comprehensive Agreement on Investment (CAI). While all countries publicly defend EU-level coordination to achieve a better bargain, in practice they have different priorities and pursue them bilaterally (Cameron, 2012). China is accused of deploying a *divide & conquer* tactic, but it is the EU who has a hard time getting its act together (Huotari, Otero-Iglesias, Seaman, & Ekman, 2015).

Third, the EU emphasizes NATO has its guarantor of territorial integrity and peace. The American military sees a *Thucydides Trap* in China's rise (Allison, 2017), and its accumulation of all sorts of powers[1] in its revisionist pursuit. The EU's promotion of multilateralism could

1 In 1990, Joseph Nye coined the concept of *Soft Power*, in contrast to *Economic* and *Hard Power*. In 2003, he coined *Smart Power*, combining *Soft Power* with the other Powers. In 2017, Walker coined *Sharp Power*, used in relation to China.

be understood as closer to China's *multipolarity* than to Trump's *America First*. Undeniably, the American and European interests differ regarding COFDI in the EU.

Fourth, there is a clear trend of *re-regulating* non-EU FDI in the EU. While liberals view concerns about national security as masked protectionism, conservatives are skeptical about FDI in strategic sectors, particularly if controlled by State-Owned Enterprises (SOE) from autocracies. In 2020, the EU has implemented an EU-wide FDI screening mechanism which maintains the member states' sovereignty but introduces EU feedback. Several EU states are also publishing domestic FDI review procedures.

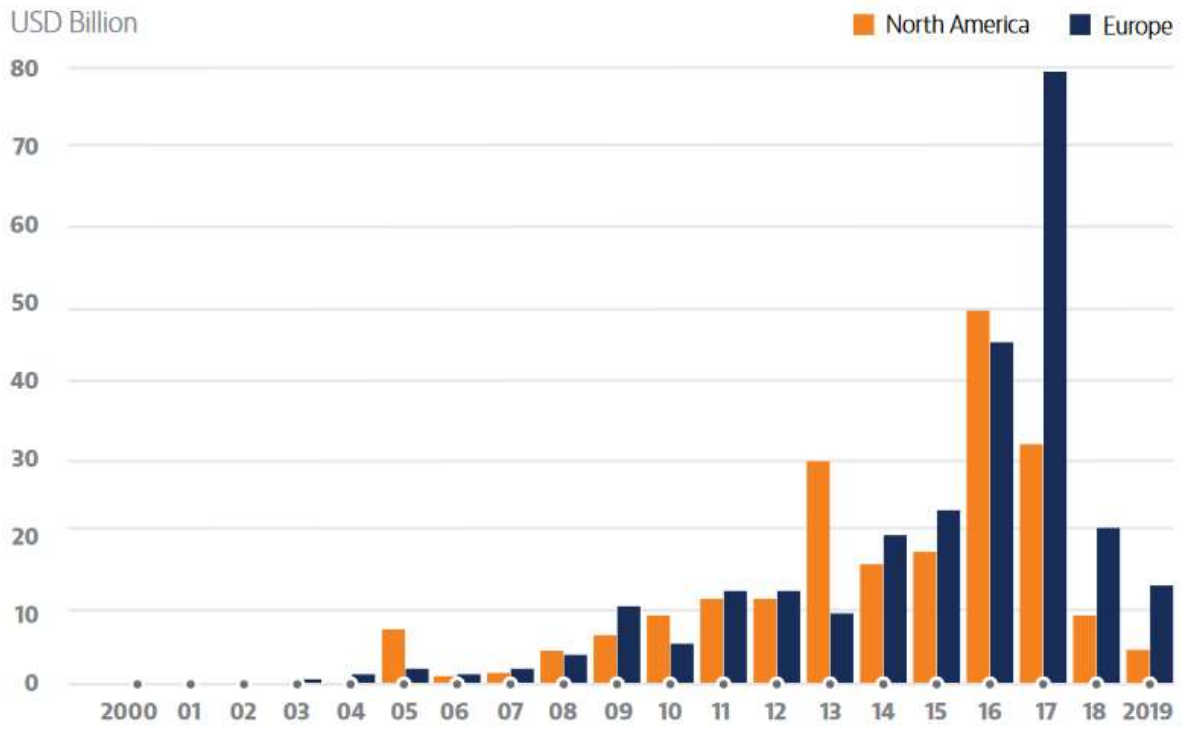
Finally, Xi Jinping is a very powerful leader, but not a "puppet master", as portrayed by *The Economist* (Reilly, 2017). The Chinese Communist Party (CCP) is a bureaucratic organization of 92 million members and there are over 200.000 Chinese SOE (Thomas, 2020). This poses important principal-agent challenges. Persuading economic actors to pursue CCP's agenda is more about aligning broad incentives than coercive threats. China, which is an experienced player, developed a sophisticated playbook of economic statecraft with Chinese characteristics, encompassing economic sanctions and incentives, sometimes looking for specific reciprocity but most commonly pursuing influence via positive strategic engagement (Reilly, 2017).

The debate about Chinese economic statecraft gets easily polarized, between the *China Threat* and the *China Normality* rhetoric. And this polarization spread across Europe.

1.2.2 The COFDI in Europe rose sharply until 2017 driven by economic and political factors from both China and the EU. The significant drop since 2018 was politically driven.

COFDI transactions in North America and Europe were irrelevant until the financial crisis, grew furiously since then until 2016-17, and dropped sharply afterwards (Figure 1).

Figure 1. COFDI transactions in North America and Europe



Source: (Mackenzie & Rhodium, 2020)

Before 1982, there was not even a legal framework for COFDI (Huang, 2011). In 1982-2000, COFDI was allowed, but controlled and not endorsed. The state policy was called minjian xianxing (民间先行) or *the non-government (private) first*. In 2000, it was substituted by zou chuqu (走出去) or *Going Out*, which was first mentioned in the *Opinion on encouraging companies to carry out overseas material processing and assembly* (1999).

At first, the *Going Out* strategy focused on sourcing scarce materials (frequently from emerging markets), promoting exports, gaining regulatory know-how and establishing R&D centers overseas. In 2008, less than 20 percent of COFDI went to advanced economies such as the EU. Figure 2 synthesizes the driving forces of the rise and fall of COFDI in Europe.

Figure 2. Factors impacting COFDI in Europe



Source: By the author

China and the EU actively promoted COFDI in Europe from the beginning of the financial crisis until 2016, for economic and political reasons. Chinese companies were seeking resources, markets, efficiency, and strategic assets. Traditional FDI motivations also apply to China as enablers of the acquisition of competitive advantages abroad, supporting state-driven *catch-up strategies*.

On the monetary side, China had accumulated too much foreign exchange reserves (FX), which posed three problems. First, it pressures the RMB to appreciate, which, if allowed, negatively impacts exports, and limits GDP growth, and if constrained generates accusations of currency manipulation. Second, the concentration of FX in USA T-bonds creates a dependence on the American monetary policy. Third, holding USA debt yields low returns when compared to well-executed COFDI. This was particularly true in 2010-15 when the USA yields were below 0.5% (Figure 3).

Figure 3. Yield (at constant maturity) of US 10yr T-bonds



Source: (Trading_Economics, 2020)

It is hard to assess how important a reason was the desire to acquire political influence over EU's Governments. It is certainly considered an upside, even if many Chinese are skeptical about the political return on COFDI. This discussion is at the heart of this thesis and presented later. What must be noted is that there are many drivers to COFDI beyond that one. The EU institutions, governments and companies were craving for COFDI when it arrived and pulled it fiercely. The financial crisis resulted in a sovereign crisis in several EU countries, which were pushed by the EU and the IMF to privatize public assets and capitalize banks and other private institutions, without much concern for the medium-term implications.

In Portugal, on April 6th, 2011, the Minister of Finance, Teixeira dos Santos, notwithstanding the opposition of his prime minister (PM), announced that Portugal and several domestic financial institutions needed a bailout (Cabral & Marques, 2014). But the Portuguese crisis was not just an outcome of the global crisis and Portugal needed more than a short-term fix. "Between 2000 and 2012, the Portuguese economy grew less than the USA during the Great Depression and less than Japan during its Lost Decade" (Reis, 2013).

The economy was overindebted and lacked liquidity for turnaround. The state needed to attract investors for public debt, for the privatization of SOE, and for deploying greenfield

infrastructure projects. Moreover, the Government wanted to foster capital injections into distressed private companies in sectors such as banking, insurance, and energy.

In 2012, Portugal was the most open country to FDI (OECD, 2012) and with many assets for sale, it caught the eye of foreign capital. China was the largest investor and "purchased 45% of the assets encompassed by the Economic Adjustment Program" (Cassaburi, 2016).

The priority of the European economic diplomacy was more about reciprocity (i.e., allowing EU OFDI in China) and respect for IP rights than limiting COFDI in strategic assets.

The sudden drop of COFDI flows since 2016-17 is mostly politically-driven. In China, the authorities were alarmed by the speed of the capital flight, which reduced FX reserves from ~USD 4Tri in 2014 to ~USD 3Tri in less than 3 years (Figure 4).

Figure 4. Chinese Foreign Exchange Reserves
USD Millions



Source: (Trading_Economics, 2020)

Moreover, the Chinese authorities realized that much of the capital fleeing was a means for extracting personal wealth from China or used by "private" companies such as Anbang, Fosun, HNA, Wanda, which at first deserved *carte blanche* to grow overseas but soon went out of control: "Once glorified as a sign of China's growing international influence, these foreign deals were now seen as giant money laundering machines for Chinese Corporations" (Collier, 2018).

The Government introduced tighter controls in 2017, limiting capital transfers in several sectors and requiring solid business cases for large investments: "Strategic investments in high technology would be permitted but what Beijing calls 'asset transfers' in property or media deals would not" (Collier, 2018).

Also, some western media became obsessed with the Chinese Threat (Figure 5).

Figure 5. Small set of China skeptical front pages at "The Economist"



Source: The Economist

Throughout the 2010s, the rationale for COFDI to deserve special concern became clearer to the public and the political elites. Some argue that COFDI has fewer positive spillovers to the host country and does not respect local standards (e.g., environmental, labor), others fear that by acquiring Western technology and access to Western markets, China can grow faster, outrunning the EU and the USA to become the leading economy. Since the early 2010s, China is not only the largest manufacturer, the largest trader and the largest FDI investor. It is already "the biggest player in the history of the World" (Allison, Blackwill, & Wyne, 2013). Worried, President Trump launched a *Trade War* on China in late 2018. Coming from the Republican side, this represented a shift in the economic engagement with China. Political scientists fear that economic engagement offers political leverage which can reduce the West's ability to promote its values in China and block the promotion of China's values abroad. The military is generally more concerned about the security implications of the sale of dual-usage technology to China or that access to critical infrastructure may enable boycott and sabotage. And yet, despite the American opposition, the EU and China concluded in 2020 the agreement in Principle for the CAI at the Council level (still pending EU Parliament approval).

1.2.3 Portugal concentrates slightly more COFDI than its fair share in Europe. Its share was higher in the beginning of the decade and decreased gradually.

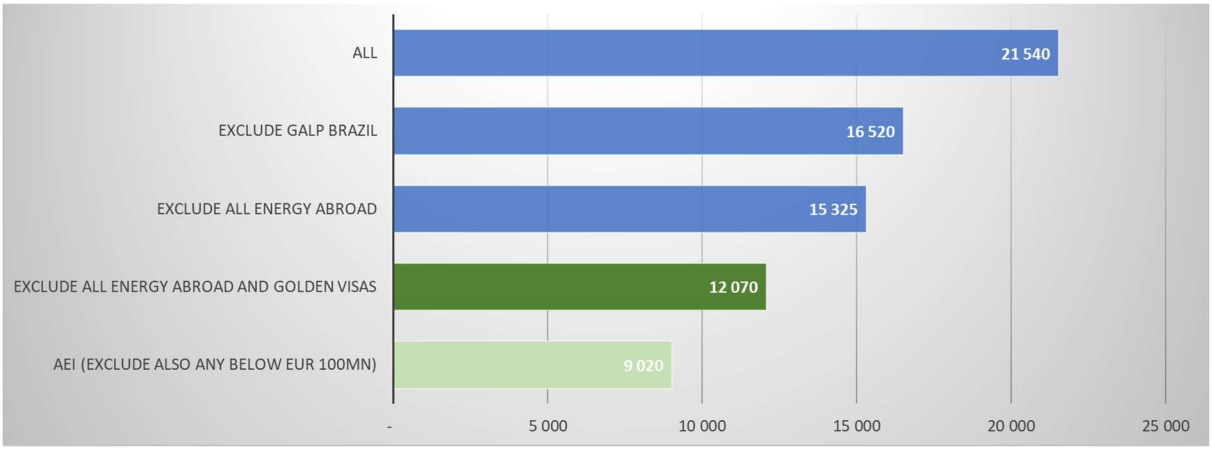
The quantification of COFDI in Portugal suffers from the well-known problems of FDI measurement. The main challenge derives from the effects of roundtrip investment and the capital circulation through fiscally-efficient jurisdictions. In the EU, these include Luxembourg (LX), the Netherlands (NL), Ireland and Malta. Portuguese FDI figures are practically useless since most of its large companies are subsidiaries of Dutch holdings, and most COFDI in Portugal is executed via Hong Kong (HK), LX, NL or other similar jurisdictions (see Chapter 4.c.i). This problem derives from the opaqueness of COFDI ownership.

The most reliable COFDI source is the China Global Investment Tracker (CGIT). Unfortunately, it only includes investments above USD 100Mn. In economies like Portugal, large deals are sporadic. CGIT only accounts for announced M&A, so it does not consider other FDI elements nor calculates the net stock (i.e., ignores divestments). Other problems with any FDI database concern the boundaries of what to consider as FDI. It is hard to discuss FDI without understanding these problems, as these four Portuguese cases illustrate:

- China Three Gorges (CTG) acquires 23 percent of EDP from the Portuguese State, and China National Investment Corporation (CNIC) acquires 5 percent of EDP in the stock market. Equity stakes <10 percent are generally not considered FDI. Are CNIC's 5 percent FDI?
- CTG commits to invest EUR 2Bn acquiring minority stakes in EDP's subsidiaries. If the subsidiary is abroad, is this FDI in Portugal? What if the cash injected in EDP is lent to its subsidiary? Should FDI be considered at commitment or disbursement date?
- Sinopec (Chinese SOE) acquires 30 percent of Galp Brazil. Is this FDI in Portugal or in Brazil?
- Between 2012 and 2019, 4467 Chinese individuals invested in Portuguese real estate (RE), ~EUR 600K each, to acquire EU residency permits. An average EUR 400m / year; EUR ~2.7Bn in total. Is this FDI? Should it be considered an investment USD >100Mn by CGIT?

This is important because these decisions may increase the amount of COFDI in Portugal in 2011-19 from USD 9Bn (CGIT) to over USD 21Bn (Figure 6).

Figure 6. COFDI in Portugal according to CGIT vs. other definitions
USD Mn. 2011-2019



Source: By the author, using CGIT database

If we compare COFDI in Portugal during 2011-19 vs. other European countries using CGIT (Figure 7), Portugal ranks 11th in volume (~2 percent of total).

Figure 7. Country ranking of COFDI in Europe/EU in 2011-2019

Europe

Country	COFDI 2011-2019	% Total	% GDP	rank % GDP
Britain	78390	23%	3%	14
Switzerland	54390	16%	8%	4
Germany	47160	14%	1%	20
Italy	24080	7%	1%	21
France	20780	6%	1%	25
Finland	16380	5%	6%	8
Netherlands	14130	4%	2%	19
Sweden	10480	3%	2%	17
Serbia	9700	3%	19%	2
Ukraine	9530	3%	6%	6
Portugal	**9020**	**3%**	**4%**	**12**
Ireland	7600	2%	2%	18
Spain	6130	2%	0%	27
Luxembourg	4680	1%	7%	5
Greece	4620	1%	2%	16
Hungary	4480	1%	3%	15
Norway	4130	1%	1%	23
Belarus	3830	1%	6%	7
Slovenia	2180	1%	4%	11
Poland	2180	1%	0%	29
Romania	2110	1%	1%	24
Bosnia	1790	1%	9%	3
Belgium	1600	0%	0%	32
Denmark	1430	0%	0%	28
Montenegro	1220	0%	24%	1
Czech Republic	860	0%	0%	30
Croatia	690	0%	1%	22
Macedonia	650	0%	5%	9
Moldova	560	0%	5%	10
Malta	440	0%	3%	13
Austria	370	0%	0%	33
Bulgaria	340	0%	1%	26
Latvia	110	0%	0%	31

European Union only

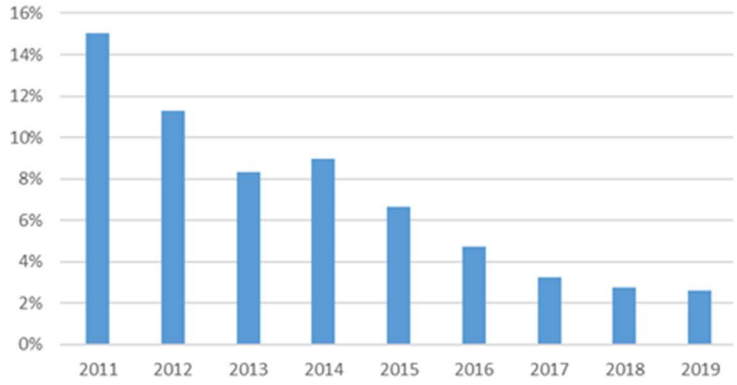
Country	20	% Total	% GDP	rank
Britain	78 390	23%	3%	6
Germany	47 160	14%	1%	12
Italy	24 080	7%	1%	13
France	20 780	6%	1%	16
Finland	16 380	5%	6%	2
Netherlands	14 130	4%	2%	11
Sweden	10 480	3%	2%	9
Portugal	9 020	3%	4%	4
Ireland	7 600	2%	2%	10
Spain	6 130	2%	0%	18
Luxembourg	4 680	1%	7%	1
Greece	4 620	1%	2%	8
Hungary	4 480	1%	3%	7
Slovenia	2 180	1%	4%	3
Poland	2 180	1%	0%	20
Romania	2 110	1%	1%	15
Belgium	1 600	0%	0%	23
Denmark	1 430	0%	0%	19
Czech Republic	860	0%	0%	21
Croatia	690	0%	1%	14
Malta	440	0%	3%	5
Austria	370	0%	0%	24
Bulgaria	340	0%	1%	17
Latvia	110	0%	0%	22

Source: By the author, using CGIT database

The USD 9Bn invested represent 4 percent of 2019 GDP, which lands Portugal in 12th place as percentage of GDP. Among EU countries, Portugal ranks higher: 8th in total volume and 4th as percentage of GDP. It is possible to argue that Portugal's share of COFDI is slightly above its fair share. Countries with higher incidence are Serbia, Montenegro, Moldavia, Belarus from the Eastern side, but also Switzerland, Luxembourg, Slovenia, and Finland.

In 2011, COFDI in Portugal was 15 percent of the EU's total, but the accumulated COFDI in Portugal in 2011-19 is only 3 percent of total European COFDI (Figure 8).

Figure 8. COFDI flows in Portugal since 2011 (% of total in Europe)



Source: By the author, using CGIT database

In 2018, CTG presented a takeover bid for a controlling stake in EDP (anything >50 percent). Despite the non-opposition from the Portuguese Government, the bid was rejected in 2019. If such investment had been successful, Portugal would have accumulated twice as much COFDI in the same period, growing from EUR 9Bn to EUR 18Bn, in which case it would rank top 5.

EDP's takeover bid sparked an active American campaign against COFDI in Portugal. Ambassador Glass landed in Portugal in August 2017, and the bid was announced in May 2018. Already on July 6th, when confronted by the press, he said that "EDP has USD 10Bn invested in renewables in the USA… we are paying close attention" (Lusa, 2018). Moreover, he explained what was different about the bid for controlling EDP: "A state entity owning some shares of a company is one thing, it is an investment. Now, buying the whole company with critical importance in the infrastructures of a country is different: it is political" (Lusa, 2018).

On September 25th, 2020, this discussion escalated with an interview with the American Ambassador by *Expresso*: "Portugal has to choose now between China and the USA". When confronted by the journalist with the accusation that the American stance sounded like a threat, he replied that the "threat comes from China*"* and that if Portugal accepted Chinese 5G, there would be practical consequences in the Defense partnership between the countries (Matos, 2020). In response, the leader of the Chinese League Y Ping Chow voiced that "Portugal has been maneuvering well the American pressure" and that the words from Ambassador Glass did not add much to the situation, "it only shows that the American have gone shameless" (Cardoso, 2020). The Portuguese Minister of Foreign Affairs (MFA) added that "it is for Portugal to make its own decisions" (Lusa, 2020), and was echoed by the American Sub-Secretary of State Keith Krach two weeks later: "we respect Portugal's right to make its own decisions" (Lusa, 2020). This incident clarified that overt pressure is not well received and is potentially counter-productive, but it may be too early to tell the impact of this incident.

1.2.4 COFDI is different from Western FDI, and the role played by the state in the Chinese economy makes it unique.

The author of this thesis worked for McKinsey & Co. in Asia and had the opportunity to serve Chinese corporations, including Chinese SOE. That experience provided insight on the complexity and opaqueness of company ownership, governance structures and party influence in China. But because the client work at the consulting firm is confidential, it cannot be used as a source for this document. Nevertheless, a public report published by McKinsey (2017) provides a good synthesis of the author's firsthand impression. The report has a section on the *myth of the invisible hand of the Party:*

> "There is a persistent suspicion that somewhere in Beijing resides a collective brain that directs Chinese companies' actions—and that the recent outbound acquisitions have been directed by this pervasive Government planning… The Government does like making plans: the extent to which it drives corporate decisions, however, is greatly

> overstated. The central Government sets an overall policy framework, and managers of state-owned firms are rewarded in career progression for advancing it, but they are acutely aware that they are responsible for their own decisions. With very few exceptions, acquisitions are identified and pursued by management teams for commercial reasons*"* (McKinsey, 2017).

Simplifications about Chinese state influence over economic agents should be downplayed. It is hard to find politically independent companies in China, but we should avoid regarding the Politburo, or the State-owned Assets Supervision and Administration Commission (SASAC), which is the public holding of the largest SOE, as puppet masters. Norris and Collier are among the Western academics providing solid (and updated) contributions on this.

For Norris, discussing if China can or cannot turn its economic power into political influence is not the right question. Instead, he looks for the *conditions under which* China is more successful in practicing economic statecraft (Norris, 2016). State's ability to *control commercial actors* is mostly linked to *State Unity* and *Goal compatibility*. Other secondary factors include *market structure* (i.e., concentration), *relative resources* (e.g., know-how of the state vs. commercial actor) and *reporting relationship* (the state owning the commercial actor, or appointing the management team, or financing it). The implication is that the CCP can control an economic agent when the interests are aligned, and the chain of command is straightforward. Control is much harder if interests diverge. An interesting concept introduced by Norris is that of *king-making*. In the presence of principal-agent challenges and fragmented market structures, state attempts to influence are channeled to backing actors which are loyal and discriminate against those who are not, therefore promoting the survival of some to the detriment of others.

In 2018, Collier published an account about the opaqueness of ownership and the complexity of state's influence in COFDI. Three main ideas are worth emphasizing.

First, *everything is also political* in COFDI. In China, the Government

> "is always involved in one way or another, either through implicit approval, general policy, indirect control, capital flows, or through direct ownership. But it is not a clear-

> cut action the way most foreigners think. … I prefer to think this more as shades of grey rather than as an abrupt division between the state and capitalism*"* (Collier, 2018).

Second, *often there is no State Unity:*

> "often there is no 'China' that is behind the transaction. It is a melting pot of competing interests. Many of these deals are the result of intense jockeying between a number of corporate, governmental, and financial institutions, each with their own agenda. These internecine battles are rarely public." (Collier, 2018).

Third, assessing the level of state control requires evaluating three dimensions: (1) *direct ownership* is different when a company is owned by SASAC, or by other Government levels, or even by a state-owned fund; (2) *political control* ranges from formal regulation and investment guidelines about FDI, to informal conversations with influential political actors, to party representation in the companies; (3) *access to capital* includes loans from state banks, to state guarantees, to access to foreign exchange.

What is important to retain about the relationship between COFDI ownership and political influence is that ownership is frequently unknown, and that information does not tell the degree of influence. SOE have their own agenda, which is an amalgamation of sub-agendas. Just like few large private firms are truly independent by Western standards.

1.3. Research questions

This thesis aims at answering the question: **"What are the political implications from the COFDI in Portugal?"**, which can be broken down into five sub-questions:

1. **Are there political motivations?**

"Is there evidence of political motivations for COFDI in Portugal or is it mostly driven by standard economic considerations of *return on investment*?"

This question is challenging and not at the heart of the problem. Motivations are subjective, multidimensional, oftentimes contradictory. Finding evidence points to existence, but not finding evidence does not prove inexistence. Nevertheless, evaluating the economic rationale of the investments provide relevant insights.

2. **Is it possible to convert economic power into political influence?**

Independently from the motivations, "what is the likelihood that China will try and succeed to convert its economic power into political influence in Portugal?*"*

This core sub-question can be split in three branches:

- Based on the experience in other countries, "under which conditions and how can China turn its economic power into political power?"
- "Is China likely to successfully convert economic power into political benefits in Portugal?"
- "Has China already attempted that in Portugal?"

Once we learn the conditions under which China is successful in influencing other countries, we can evaluate if such conditions are likely to be present in Portugal. Finding evidence regarding the third branch would require investigative competences beyond those of this thesis.

3. **To promote which goals?**

"Which political benefits would China try to acquire if it had political influence in Portugal?"

First, what makes Portugal relevant to China on political/strategic terms? Second, if China

cannot be understood as a single body with cohesive interests, then which objectives enjoy enough internal alignment to be effectively promoted?

4. **What does Portugal want from China?**

"How do the Portuguese stakeholders perceive the relationship with China, and the role of COFDI within it?"

Portugal, as a historical maritime power with recognized diplomatic acumen, inherited valuable relationships with the world powers. From the USA to the UK, Brazil, Africa, India, Japan or China, Portugal enjoys a global network of partnerships. Domestic stakeholders understand the strategic value of such relationships but differ on their assessment of how to balance the engagement with China and the discomfort it generates in Brussels and Washington.

5. **How to deal with it?**

"What can Portugal (and the EU) do about the current stock of FDI and what could be the framework to deal with future investment processes?"

The new EU-wide FDI regulation is a first step, and a lot will have to be fleshed out by the EU member states in the next few years.

1.4. Research hypothesis

The main hypothesis is that COFDI in Portugal is generally beneficial to the country and the concerns about political influence are exaggerated. The risk is concentrated in specific cases which must be effectively dealt with by standard regulatory processes. China is not likely to try to coerce Portugal to behave contrary to its strategic interests, and it is even less likely to succeed. Chinese economic statecraft in the EU is likely to remain at the level of positive strategic engagement focusing on economic cooperation and on the buildup of multilateralism. Portugal should not develop its relationship with China at the expense of the EU, nor should it dishonor its transatlantic commitments. But it is conceivable that Portugal incorporates a Chinese axis to its foreign policy, alongside the EU, the USA, and the Community of Portuguese Speaking Countries (CPLP). Not doing so would be ignoring the prominence of China in the new world order and wasting the long-lasting relationship of trust and mutual respect.

The alternative hypothesis is that the economic benefits to be drawn from further engagement with China do not compensate for the inherent political risk. There is enough evidence that COFDI is politically motivated, and China is likely to try and succeed in subverting the EU member states in the pursuit of bandwidth to promote political objectives opposite to the EU interests. Therefore, the EU, Portugal, and other member states, should apply tighter controls to COFDI, steering it to secondary sectors, and aim to scale it down in the medium term.

These alternatives are the boundaries within which the reader shall be able to locate itself after reviewing the evidence herein exposed. This thesis does not aim at prescribing an answer, but rather at shedding light onto some facts grossly agreeable upon and at identifying with transparency the debates which remain open in the foreseeable future.

1.5. Research rational and originality

The COFDI topic is gaining political relevance in the EU, particularly since 2017, and enjoys significant press coverage and scrutiny. The quantification of COFDI and the evaluation of its determinants are also capturing academic attention. Two early examples were *Chinese investment in Europe 2015-16* (Cassaburi, 2016) and *A New Record Year of Chinese Outbound Investment in Europe* (Hanemann & Huotari, 2016).

Regarding the Portuguese case, there are a few papers skimming through the theme, but no scientific analysis dissecting it. Before explaining the rationality and originality of this thesis it is important to acknowledge some prior contributions.

Economic Statecraft and Foreign Policy (Blanchard & Ripsman, 2013) offers a modern political theory of economic statecraft providing input for the development of an indicator measuring political influence potential. Its theory is applied to six case studies, none related to China. This may be the best theory developed to date and effective for short-term actions with clear reciprocity mechanics. As the authors recognize, it is less effective with long-term *strategic engagement* strategies because the outcomes are harder to evaluate. This is problematic because the Chinese model of economic statecraft relies a lot on those.

The most direct contributions to this thesis are (Norris, 2016), (Reilly, 2017) and (Reilly J. , 2021). Both authors analyze the Chinese economic statecraft mechanisms with depth but do not look at Portugal as a target country. (Le Corre & Sepulchre, 2016) and (Hellström, 2015) review the context and magnitude of COFDI in the EU and analyze the perceptions about its potential strategic implications.

In Portugal, despite frequent and topical press coverage, COFDI is not well understood. One problem resides in the absence of a standard methodology for evaluating the political influence potential (PIP) of COFDI in a country. A second problem is the lack of in-depth academic analysis about COFDI in Portugal. The outcome is a polarized debate, without structure or a

common understanding of its basic facts. This thesis fills these gaps by providing a methodology to assess the PIP of FDI and applying it to Portugal. It innovates by constructing two primary sources of insights based on 65 in-person interviews:

- First ever bottom-up analysis of COFDI, presented as a library of case studies;
- Analysis of the perceptions of key local stakeholders about COFDI and its implications.

From these, it draws fact-based insights about the status of COFDI and extrapolates how Portugal and the EU can deal with it.

Another methodological novelty is the application of *network analysis* for data clustering. This technique segments the COFDI cases based on their PIP and its contributing factors. It also clusters the stakeholders interviewed. The clustering offers analytical precision in segment-based generalizations obtained from interviews. The usage of *two-mode social network analysis* for clustering the FDI cases and perceptions is pioneer in the field, making it potentially replicable by other researchers.

1.6. Research structure and approach

This thesis is organized in three parts: *Part 1. Theoretical foundation and existing literature; Part 2. Methodological approach and empirical study; and Part 3. Conclusion*.

The Part 1. is a grand analysis of the existing literature. It reviews what was developed by the academia and other sources to establish the background of the ongoing debates. It also identifies gaps which defend the rationale and originality of this thesis. *Section 2. Theoretical foundation* is the most conceptual in Part 1. It is organized in five subsections, covering the theoretical fields related to the topic, which falls within International Relations (IR), where it touches directly upon International Political Economy (IPE), Geopolitics and Foreign Policy Analysis (FPA). It also scratches International Economics, International Business, and Sociology. The five subsections are *2.a. IPE; 2.b. Theories about rising powers and the case of China; 2.c. Geopolitics & Foreign Policy Analysis; 2.d. Economic Statecraft and Geo-economics*, and *2.e. Foreign clout in regime evolution.*

Section 3. Understanding China and its relations with the EU describes the relevant state and supra-state entities. It starts with a *Primer on China*, followed by a *Primer on the EU*. Once it is established a basic understanding about the internal dynamics and the foreign policies of these two entities, subsection *3.c The EU-China relationship* presents their relationship. It adds Portugal into the equation in subsection *3.d The Portugal-China relationship.*

Section 4. COFDI in the EU presents the existing knowledge about COFDI in the EU. It defines the key concepts and then presents the traditional FDI theories. Sub-chapter 4.c. *COFDI quantification and its determinants* presents what is known about COFDI discussing the existing sources, quantifying and characterizing it across several dimensions, and presenting what is known about antecedents, decisions, and outcomes. Section 4.d presents the evolution of the FDI policies and regulation. The chapter ends with a revision of FDI in Portugal.

Section 5. Chinese Economic Statecraft is organized in two subsections: one distinguishes Chinese economic statecraft from Chinese political warfare, and another presenting the learnings from the existing Chinese economic statecraft literature. In highlighting the existing gaps, it clarifies the opportunity and timeliness of academic production, diving into the Portuguese case of COFDI, and surfaces the lack of a commonly agreed methodology for evaluating the PIP of COFDI. These gaps are addressed in *Part 2*, which present the main end products of the thesis.

Section 6. Measuring Political Influence Potential (PIP) of COFDI explains the importance of having a methodology to measure the PIP of COFDI and how the methodology was developed. Subsection *6.b.* details the methodology, which consists of developing case studies for each investment, qualifying them according to several defining features of the investment, the investee, and the target. It develops six propositions which, if corroborated by the case study, indicate higher levels of PIP. It also suggests an algorithm to aggregate all features and calculate the PIP as a comparable indicator. This thesis does not suggest a methodology to estimate the PIP of the overall stock of COFDI in each country. Nevertheless, section *6.c. Reflection on PIP of the stock of FDI in each country* presents some ideas to consider when attempting to evaluate it.

Section 7. Uncovering COFDI in Portugal presents the bottom-up analysis of COFDI in Portugal between 2011-19 as a library of 29 case studies and the analysis of the perceptions of the key stakeholders. **If the reader is a specialist in Chinese economic statecraft and is looking for a source of newly-developed data and fact-based knowledge, this is the "must-read" section**. The first of these contributions uses not only the information publicly available on companies' websites, annual reports, and press articles, but also in-person interviews to 18 key participants in the investments (both Portuguese and Chinese). The approach used follows Yin's methodology (Yin, 2008), organizing the information in three sections (environment,

strategy, performance) and evaluating if each case corroborates a set of key propositions. Beyond the six variables mentioned in section 6.b it also analyzes the adherence to propositions related to the motivations and the economic performance.

Subsection 7.a. Aggregate stock of COFDI in Portugal presents the evolution of COFDI in Portugal. Subsection *7.b. Library of COFDI case studies in Portugal* presents the methodology used to build the library of case studies. In Appendix A, all investment case studies are presented. Less relevant cases are presented in shorter formats. Subsection 7.*c Main insights from the case studies* develops a network analysis identifying the clusters of COFDI based on their PIP, and extracts generalizable findings. *7.d. Perceptions of key stakeholders about PIP of COFDI in Portugal* is constructed based on in-person interviews. In Appendix B, there are 42 one-pagers synthesizing the most relevant contributions from each interviewee. The interviews were semi-structured based on an interview guide, which was delivered upfront, but the interviewees could skip some questions and were encouraged to go beyond the script. Their perceptions are reorganized around nine questions.

Part 3 – Conclusion, encompasses the *key findings*, the *implications moving forward* and the *limitations and suggestions of future research.*

Part 1 – Theoretical foundation and existing literature

2. Theoretical foundation

2.a. International Political Economy

International (or Global) **Political Economy** has to do with IR, with politics and with economics. It is "the reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power" (Gilpin, 2001).). It is possible to clarify the state-of-the-art in Western IPE by exposing two main debates.

The *first debate* opposes (neo-)realist perspectives vs. (neo-)liberal perspectives. While the first explain the state behavior with emphasis on its identity and interests, the second add that institutions play a critical role in constraining and influencing it. In his masterpiece, Wendt created a *via media* by bringing the sociological concepts of constructivism and constitutive effects into IR. Because of him, it is now consensual to recognize that states' identities and interests are intersubjective and co-constructed by the interactive process with the other states and the system as a whole. Illustratively, it is intuitive that both China and the EU are institutions *in the making*, with evolving interests and capabilities. The same rational applies to other states, like Portugal, and non-state institutions, like the United Nations (UN). The commonality about these IPE schools (realist, liberal and social constructivist) is the preference for the system and the state levels of analysis (see Subsection 2.a.i). There are other relevant theoretical contributions from IPE to the topic of the thesis, including those explaining the EU integration process (see Subsection 2.a.ii).

The *second debate* is simultaneously epistemological and geographical, opposing the *positive-only* American school and the *normative-also* British school. In the USA, priority is given to hard empiricism, and "grand conceptualization is generally eschewed" (Cohen B. , 2014). The objective is to "understand how the world works, not to judge it". One of the hottest subjects is

the interaction between the domestic and the international, which is covered by a school coined by Robert Bates (1997) as *Open-Economy Politics*. The American way is reductionist and focuses on objective questions, as narrow as possible, which can be scientifically proven. The British school is normative, searching for justice and aiming at making the world a better place. It is more adept of qualitative methods, more contextual and interpretative.

Finally, given China's centrality to this thesis, it is important to consider the Chinese contributions to IPE (see Section 2.a.iii). There are three important notions to acknowledge about the present Chinese IPE thought: Marxist root, State Centricity and China Centricity. These characteristics can be understood by the ontology of Chinese IPE itself. The Chinese academy is supposed to track the developments of the actual governmental policy, help explain it and endow it with theoretical robustness. One of the ongoing debates it about the need for a Chinese IPE School, or if instead, Chinese input should be incorporated into the global theories.

2.a.i. (neo-)Realism, (neo-)Liberalism and Wendt's Constructivism

IR has been subject of study for centuries, but its emancipation from politics or political science is recent, reasonably situated during the inter-war period: "During the 1920s new centers, institutes, schools, and university departments devoted to teaching and research in IR were created in Europe and North America" (Britannica, 2020). IR is "the study of the relations of states with each other and with international organizations and certain subnational entities (e.g., bureaucracies, political parties, and interest groups)" (Britannica, 2020). This independence is still not universal and IR remains a subset of political science in multiple universities worldwide.

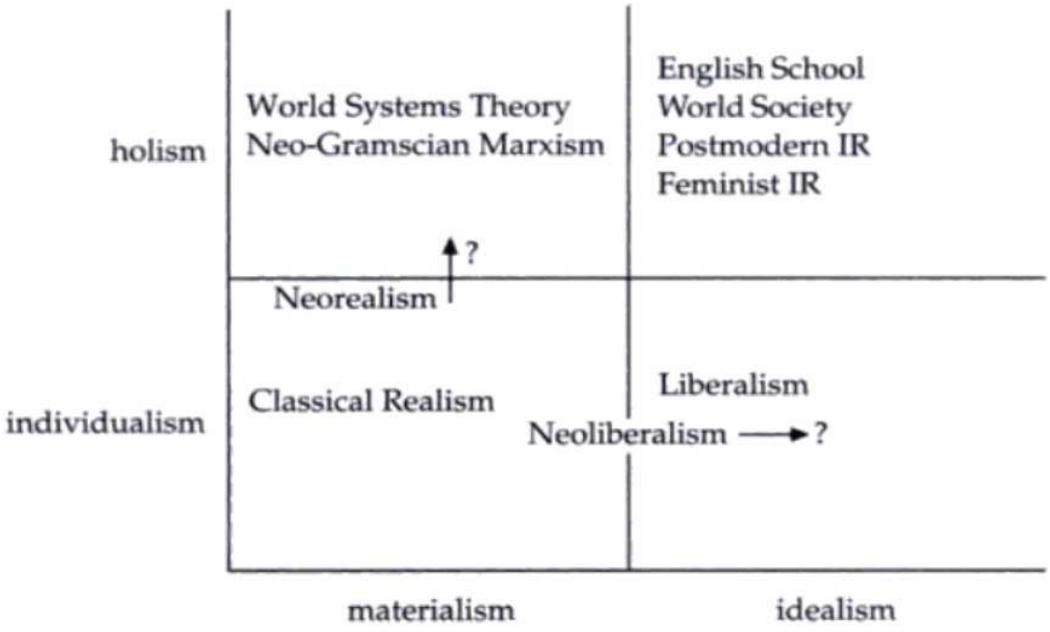
In describing the evolution of IR, it is useful to start from the three images that Kenneth Waltz proposed in *Man, the State and War* (1959). He organizes the causes of war (which are a proxy for the interactions among states) around three images (or levels of analysis), that guide IR researchers. The first is about the individual (and its defects), the second is about the state (and the defects in their internal organization), and the third is about the inter-state system (the state's external organization), which is anarchical.

Waltz explains the relevance of each image. The *Theory of International Politics* (Waltz, 1979) is about the system level whereas the theory of foreign policy is about the state level and below. These two complementary perspectives help understand the different levels of the multilayered chessboard where states, institutions and their constituencies play (with) each other.

This subsection resides between the system and the state levels, and in the FPA's subsection we go down to the space between the state and the individual. Realism, liberalism, and constructivism are between the system and state because while they may disagree about the role played by the state's identities and interests or the role of institutions, they do not discuss where these come from. These theories take such elements as exogenous, contrary to what is done by FPA or individuals' analysis.

To compare the systemic theories, it is interesting to use a figure developed by Wendt, which locates them in a matrix according to two dimensions: (1) holism vs. individualism; and (2) materialism vs. idealism. It is called the *Four Sociologies of International Politics* (Figure 9).

Figure 9. Wendt's Four Sociologies of International Politics



Source: (Wendt, 1999)

The x-axis displays the relative importance of the nature and organization of material forces vs. ideas in social life. The left side is called materialism and the right side is called idealism

> "At least five material forces recur in materialist discourse: (1) human nature; (2) natural resources; (3) geography; (4) forces of production and (5) forces of destruction. These can matter in various ways: by permitting the manipulation of the world, by empowering some actors over others, by disposing people toward aggression, by creating threats, and so on. These possibilities do not preclude ideas also having some effects (perhaps as an intervening variable), but materialist claim is that effects of non-material forces are secondary." (Wendt, 1999).

On their side, idealists believe that "the most fundamental fact about society is the nature and structure of social consciousness*"* or shared beliefs (Wendt, 1999). The world is not black or white for the proponents of these theories, but they can be located along the continuum with some level of agreeability.

The y-axis displays the relative role played by structure in social life. Understanding the difference between individualism or holism (i.e., structuralism) requires grasping two conceptual distinctions:

- **Distinction 1: causal effects vs. constitutive effects** – in a causal relation, condition X generates an effect in Y, means that X *is* prior to and thus *exists independently* of Y. In a constitutive relationship where X is what it is in virtue of its relation to Y, X presupposes Y, exists simultaneously and their relationship is necessary, not only contingent. As an example, in a slave society masters and slaves are constituted by a social structure called slavery but masters *do not cause* slaves because masters *cannot be* without slaves
- **Distinction 2: effects of structures on agent's properties, especially their identities and interests vs. effects of structures on agent's behavior** – if the system constrains the agent, it only limits its behavior, but if the system constructs the agent, it has property effects. Property effects have behavioral implications but not the other way around.

These distinctions help understanding why individualism is associated with causal effects of structures on behavior, and that individualists tend to treat identity and interests as exogenously-driven and address only behavioral effects. Individualism is bottom-up and holism implies a top-down understanding of social life: "holism holds that the effects of social structures cannot be reduced to independently existing agents and their interactions", and the structure effects construct agents in both causal and constitutive senses (Wendt, 1999).

So, what are the main IR theories, and where are they in Wendt's matrix? In schematic terms

- **Classical realism** sees an individualistic and materialist force driving states from a bottom-up creation of the state's interests and identities based on those of the agents. These ideas, dating to Machiavelli and Thucydides, had their final distillation by Morgenthau: "The realists of the periods just before and after World War II (Niebuhr,

Carr, Morgenthau, Herz, et al.) are often referred to as *classical realists* today, but the term applies with still greater justice to Thucydides and Machiavelli" (Forde, 1995).

- **Neorealism** moves "up" from classical realism, limiting the role of ideas but seeing state's interests and identities more constructed from the system's anarchy than emanating from the agents' attributes. The structure regulates behavior but does not construct identities, so Wendt sees this theory between individualism and holism. It is important to mention at least three variations of this school: Waltz's structural realism, Mearsheimer's offensive realism, and Gilpin's hegemonic theory:

  > "Structural realism as developed by Waltz argues that the anarchic system and the distribution of capabilities are powerful constraints and inducements which produce "sameness" in the behavior of states. For Waltz, international relations is anarchic and not hierarchical, populated by functionally similar units, and the structure of the international system or polarity varies based on the distribution of capabilities […] offensive realism seeks power and influence to achieve security through domination and hegemony […] defensive realism argues that the anarchical structure of the international system encourages states to maintain moderate and reserved policies to attain security" (Lobell, 2017).

  Gilpin differs from Waltz in the centrality played by the international political economy in the interaction among the market, the states, MNE, and other organizations. He helps understanding the relationship between Portugal, the EU and China due to the "emphasis given to the economical, commercial, technological, scientific, and cultural, to which it is not irrelevant the absence of a security angle (and a common enemy), so dear to traditional alliances in Morgenthau's classical realism" (Gonçalves, 2011). Gilpin's hegemonic theory argues that the existence of a hegemon increases the system's stability and that after a *hegemonic war* the hegemon spends its energy securing its hegemony.

- **Liberalism** focuses on the role of domestic factors in shaping the state's interests, but still constrained by institutions. States are the *individuals* at the system level, therefore Wendt places liberalism in the lower-right quadrant. Classical liberalism dates to Voltaire

and Locke, but it is in Kant's *Perpetual Peace* where neoliberals search for higher inspiration. He foresaw the unlikelihood of democracies to wage war against each other, but also their proneness to engaging militarily with autocracies.

- **Neoliberalism** agrees with neorealism that power and interest are essential pillars of the system but believes that the institutional superstructure plays an autonomous role. Kant's *Perpetual Peace* is a reference to Keohane and Nye, two influential neoliberalists. The concept developed in opposition to neorealism is the *complex interdependence* which argues that states interconnect in modes beyond *Westphalia*, being it trans-governmentally or transnationally, because they are not the sole units nor act as coherent units. Ikenberry distinguishes between (domestic) liberalism and liberal internationalism: "In the hands of F. D. Roosevelt and his generation after 1945, liberal internationalism became to an even greater extent an agenda for building an international community within which liberal democracies could be stabilized and protected" (Ikenberry, 2018).

Realism and liberalism gave space to neorealism and neoliberalism in the 1950s, which means that, for long, the common ground of the discussion was on the understanding of the system as driven by state-level interests and identities. The dispute was mostly about the relative importance of power and interest vs. ideas and institutions.

While there are schools arguing against centering this debate at the bottom half of the matrix (especially materialistic & holistic perspectives, such as Wallerstein's *World systems approach*), the decisive blow came from the top-right quadrant, which is the *constructivist* quadrant. The quadrant's defining feature is the belief that the international structure consists of shared knowledge, which affects state's behaviors, interests, and identities.

Constructivism applied to international politics constitutes useful background for this thesis. Constructivism, defined in opposition to rationalism, meaning that identities and interests are

socially co-construct and are not simply given (like rationalists uphold), and understanding states are unitary actors with identities, interests, and intentionality.

This is an ontological discussion, and going deeper it does not help this thesis any further. So, linking back to the research questions, why does it matter for us if power and interest are constituted by ideas? Or where do these come from?

If we are interested in the space between the state and the system, this is materialized in questions about the normative power of the EU in the world order or the intersubjectivity between the Chinese civilization and the Western states when their agents interact, being it through the Chinese MNE investing in Portugal or the summits between President Xi and President Marcelo. It also sets the stage for reflections about the role of individuals in shaping the world order. Does President Xi behave in an inevitable manner considering China's interests and identity or does he define or shape them differently than Zhou Yongkang would? Would there be a trade war between the USA and China if Hilary Clinton, not Donald Trump, won the 2016 USA Presidential elections? Would Portugal be less welcoming to COFDI, in 2020, if former PM Passos Coelho was still PM?

2.a.ii. IPE theorizing of the EU construction

Section 3.b. provides a *primer on the EU*. But before we get there, for the readers less familiar with the EU fabric, it is important to clarify that "as an entity, the EU is neither a state nor an international organization" (Verdun, 2017). It has elements of both, and its architecture includes representatives of the individual states and supranational decision makers, and responds to pressures from civil society (Verdun, 2017). What is decided at the EU level and what remains at the state level is a long discussion, and the history of the EU integration is marked by how it evolved. The European integration started at the state level, requiring unanimity for approval and, with time, some themes moved to the EU level (requiring only some sort of *majority*).

In deciding what is more important to present in this thesis about the interception between IPE and the EU, two key subjects emerged: explaining the EU integration through the lens of IPE, and the role of the EU as an economic (and normative?) global power. The first is covered in this section and the latter is covered in Subsection *3.b.*

In IPE terms, the EU integration process is better understood through the lens of three theories: *Neofunctionalism*, *Intergovernmentalism* and *Supranationalism* (Conceição, 2016). *Neofunctionalism* postulates that the EU integration is initiated (in the 1960s) by the formation of a functional nucleus of political elites, whereas *intergovernmentalism* points out how nation-states use the integration process in a quest to increase their veto power (as it happened in the 1970s), and that integration was enabled by the convergence of the interests of the (strongest) individual states. *Supranationalism* emphasizes the emergence of supranational policies.

Neofunctionalism argues that there are very important actors in the international scene beyond the states: "Neo-functionalists focus their attention on the role of supranational institutions and non-state actors, such as interest groups and political parties, who, they argue, are the real driving force behind integration efforts" (Jensen, 2019).

Realism focuses on the power games among states, whereas *neofunctionalism* postulates that economic integration leads to economic growth, which raises everyone's welfare. It is not a zero-sum game. *Neofunctionalism* acknowledges that outcomes of integration movements are uneven but from the "positive-sum" principle it presumes that supranational elites emerge to advance the integration process, which is value-enhancing to all. Package deals, which include "apparently discrete issues as a single (composite) item", enable most of the actors to safeguard their interests (Jensen, 2019).

Intergovernmentalism, argues against the inevitability of the EU integration and federalism. Nation state will perdure based on two unsurmountable factors: territorial sovereignty and political legitimacy. The nation state is obstinate but not obsolete (Hoffmann, 1966).

Until the 1980s, the Europeans appreciated state interventionism: "during the 1960s and 1970s European policymakers can be characterized as having been of one mindset, namely to see a strong role for state intervention in the economy and a limited role for the market […] however, one can trace back to the early 1980s a change of paradigm" (Verdun, 2017). That change happened in the role of the market and the role of monetary policy. The EU constructed the largest domestic market in the world and the largest currency union, but this evolution "led to a mix of winners and losers […] winners were and are those that could do well in an increasingly integrated market". State monopolies were broken down and local champions were confronted with foreign competition. The consumer prices dropped but the overall balance uneven. The same happened with China's ascension to the WTO and its economic integration with the EU. For some countries, like Germany, which had the efficiency, the technology, and the capital, the outcome was clearly positive. For less competitive economies it resulted in a mass destruction of native industries.

2.a.iii. Chinese contributions to IPE

Stricto sensu, the Chinese conception of power in IR is not different from Western realism. Several Chinese authors defend that the genesis of realism dates to pre-imperial China, even before Thucydides (Carriço, 2018). From a contemporaneous viewpoint, "the origins of IPE inside China trace back to the visits of American scholars in the mid-1980s, who introduced IPE readings in their guest teaching in China" (Chin, Pearson, & Yong, 2015). Native contributions started in 1980s, and in the 90s it was a distinct field in Chinese universities.

Since the 50s, Chinese scholars were commanded to assess IPE from a Marxist viewpoint, and at the time of this intellectual opening the realist school was predominant. Presently, Chinese IPE thinking has some defining characteristics. First, it maintains a strong influence from the Marxian political economy:

> "even if the Marxian ranks are dwindling, is not surprising if one considers that Marxian political economy was practiced as the unchallenged approach for many decades, and given that Marxism served as the basis for the study of all politics, economics, philosophy, sociology and history after the founding of the PRC" (Chin, Pearson, & Yong, 2015).

IPE in China is also characterized for being China-centric, state-centric and normative:

> "the overarching concern for the impact of the global economy on China, on Chinese national interests as defined by the state, and on the questions of how China should respond […] there is usually direct linkage between scholarship and the emphasis on policy prescription, and the scholarship is quite explicit about its normative underpinnings." (Chin, Pearson, & Yong, 2015).

Nowadays, China has a significant IPE production and one of the ongoing debates is about the necessity for a Chinese school of IPE thought. One of the main contributors, Xuetong, explains that, throughout history, every time China got close to global preponderance, there was an internal debate about the main guideline for foreign policy: hegemony vs. humane authority. As he advocates for the latter, his proposal is called *moral realism*. For him, humane authority

> "requires the leading power to practice humane norms both domestically and internationally. This means the Chinese government has to shift its priority from economic interest to political concerns. Its foreign policy should give top priority to making more strategic friends rather than merely creating a favorable environment for economic construction, and domestic priority should be given to social justice and fairness" (Xuetong, 2011).

Circling back to Section 2.a.i., Xuetong can be seen as someone who understands the relevance of economic and military power for national affirmation but still believes that those elements are secondary to the political leadership that acts and its morality, which are the key to national power. He believes that global order "is bound to be hierarchical, with some states being dominant and others less influential. But dominance is achieved mainly by morally informed political leadership rather than economic or military power" (Xuetong, 2011). For him, it is not important that China has its own IPE school, but the ancient Chinese thought may provide the needed input to develop a new school with its own central "hard-core" irrefutable hypothesis, probably explaining the fall of the American hegemony.

Constructivism is a "novel theory of IR from a Chinese perspective" (Chin, Pearson, & Yong, 2015). It arrived in China with the translation of Wendt's work by Yaqing Qin, the author of *A relational Theory of World Politics* (2018). It is not surprising that Qin's thinking is eminently Wendtian. He postulates that the international behavior of a state is determined by its international identity and points to three alternative identity options: the status quo state, the isolationist state, and the revisionist state. The first appreciates the existing order, the second is estranged from it, and the last wants to change it. The status quo state can align itself with that alternative because it is coerced to that position, because it develops a positive identification with the existing order by realizing that its economic interests are closely linked to the international community, or because it develops a positive identification through socialization into the common ideologies, values, and beliefs. The third option leads to most stable change. For Qin, China was revisionist before the 1970s, it was isolationist during the 70s, and since

the 80s it is a status quo state with a lot to gain from the established order. China is a main beneficiary of the world order of the last three decades.

The main topic of Qin's book is that of *relationality*, which he contrasts with Western's "rationality". He understands that the Western and the Chinese civilizations need to acknowledge their differences, and these two concepts mark their divide. The Chinese see the world "as one composed of complex relations and the social world as one composed of human relations, giving 'relation' an important ontological status and assuming humanity as the key to understanding the social" (Qin, 2018). This relationality has always been at the core of Confucianism. Qin proposes a step back, arguing that too much "rationality" without humanness in Western IR is dangerous for the relations among states. Like Xuetong, he proposes an alternative IR view, rooted in the distinctive values' system of the Chinese Civilization.

2.b. Theories about rising powers and the case of China

2.b.i. Alternatives for the rise of China

One of the few Portuguese contributions about China's rise is *The China rise – Peaceful Accommodation or Great War* (Vasconcelos, 2009), which sketches four alternative scenarios: S*cenario 1 – Implosion* is the theory of a coming collapse of China where internal tensions arising from social unrest and economic underperformance undermine the legitimacy of the regime, which is incapable of dealing with a chaos enabled by an exterior force interested in it. The CCP has proven to be very resilient, and this scenario is unlikely in the next decades.

S*cenario 2 – Stagnation* is marked by a sharp deceleration of China's GDP, either self-motivated, in a movement of isolationism, or imposed from abroad in a containment attempt. This scenario is plausible but requires that the USA convinces the largest economic blocks to mitigate their economic engagement with China, which is challenging. In the EU, where most countries grow <2 percent annually, this would mean a self-inflicted recession.

S*cenario 3 – Progressive rise within the order* is one of benevolent continuity, where China's growth follows a soft landing, enabling China to successfully migrate from an investment and export-based economy to a consumption economy. This scenario does not exclude some irritants in the relationship with the other powers but conceives that China is allowed to rise in mutual accommodation. This creates a multipolar order where each block has its sphere of influence, but economic integration prevails.

S*cenario 4 – Chinese challenge to the international order because of its rise* is a scenario where China departs from Deng's *peaceful rise* and accelerates an arms' race and a military expansion against the USA. China has strategic vulnerabilities, such as the dependence on oil imports, most of which is transported by sea, facing several choke points (e.g., Malacca), and China's navy may struggle to protect its merchandise. An externally triggered example would be an

independence declaration in Taiwan. Territorial integrity is an essential pillar of China's nationalism (which is itself a source of regime legitimacy), therefore requiring Chinese military intervention. This scenario is the most dangerous and alarming for the world order and its plausibility demands accommodation on both sides.

It is understandable why the main IR theories embraced the rise of Communist China at the time of Kissinger. From the realist perspective, the West's opening to China was a masterful blow against the common Soviet enemy. At that time, forecasting how China's identity, interests and behavior would change with the transition from Mao to Deng was impossible. Even for Toynbee, the greatest historian of the time, China could go either way:

> "China was immensely humiliated from the Opium War until the communist took power, and, if you have been humiliated, you react by becoming aggressive. One feeling in China must be that China must have power in the modern sense […]. That is one possible reaction. The other possibility is that the Confucian point of view, which is essentially one of moderation and balance, rather like the Greek ideal – the golden mean, which the Greeks never practiced – may prevail. After all, the Confucian attitude toward life is deeply rooted in China […] it will be a tug of war between these two tendencies" (Toynbee, 1974).

But 15 years later, once that enemy was defeated, intense debate started among realists about the implications of furthering the economic integration. From the liberalism and constructivism perspectives, it was consensual that engagement could drive China's adherence to multilateral institutions, which would gradually introduce it to Western standards. This interaction would hypothetically allow for the superior Western ideas to proliferate in China and eventually shape it westwards. The former Governor of Macau, General Rocha Vieira, interviewed herein, mentioned that, in 1991, President Soares told him that "China will be a liberal democracy before 2000". To illustrate the debate going on in the 1990s, it is possible to use Shambaugh's work. In setting the debate, he said that it was a hot topic, and very hard to predict the outcome:

> "The uncertainties about China's future capabilities and intentions, and the debate about alternative policy options, have spawned a lucrative cottage industry among analysts

> and pundits in academia, corporations, banks, governments, and the media worldwide. Analysts can reasonably estimate China's economic and military power a decade or more hence based on its present and projected financial, technological, and material resources. Far more difficult to predict is China's internal political and social cohesion, and how Beijing will wield its new strength" (Shambaugh, 1996).

He foresaw that engagement was hard but there was no alternative to trying it. China integrated immensely and willingly, becoming the 2nd economic powerhouse already one decade ago. It played mostly by the rules and responsibly. According to Foot & Walter, who compared China and USA's behavior, China improved through time. Both countries could be more consistent (Figure 10).

Figure 10. Behavioral Patterns of China/USA across five issues

	Use of Force	Macroeconomic Policy	Nuclear Non-Proliferation	Climate Change	Financial Regulation
Description	1. No use, except in self-defence 2. *Responsibility to Protect*	1. Surveillance over Fx rate 2. *Balance surplus vs. deficit countries*	1. Respect own role 2. *Export standard* 3. *Inspection* 4. *Peaceful use*	1./2. Adhere to protocols (e.g. Kyoto) 3. Use market mechanisms	1. No use, except in self-defence 2. *Responsibility to Protect*
USA consistency	1. Low 2. *Mixed*	1. Low 2. *Higher*	Relatively high, at times inconsistent: Pakistan, India, Israel	Low generally; not Kyoto compliant	High on Basel I, moderate and partial on Basel II
China consistency	1. Gradually higher 2. *Not blocking*	Initially moderate now low	Low initially, now higher; reluctant to sanctions	Improving significantly	Gradual/partial, in similar timetable to the USA

Source: By the author, based on (Foot & Walter, 2011)

At the same time, China's regime gained political legitimacy from the economic success which enabled the fastest and largest emancipation out of poverty in the history of mankind. According to the World Bank (WB), more than 850Mn Chinese were lifted out of extreme poverty. China's poverty rate fell from 88 percent in 1981 to 0.7 percent in 2015 (World_Bank, 2020), as measured by those living on less than US$1.9/day in 2011 purchasing price parity terms.

While realists were skeptically supportive of China's rise, constructivists and liberals were whole-heartedly for it. Their main frustration is that CCP opened economically while keeping an authoritarian political regime, and, through a state capitalism model (see Section 3), China could develop a powerful economy where SOE and state financing are central.

At the time, some argued that China's potential was overestimated: "[it] is merely a middle power. It is not that China does not matter at all, but that it matters far less than it and most of the West think. China matters about as much as Brazil for the global economy" (Seagal, 1999).

The debate about China's rise is polarized between the *China Threat* and the *China Normality* schools. The first is umbilically linked to the hypothesis, sometimes quoted as a golden rule, called the *Thucydides Trap* (presented in 2.b.ii). Many realist thinkers go beyond the historical analysis and develop theories to prove the inevitability of the rule, and then apply it to China as an argument for its containment and deterrence. The *China Normality* school has long lived in the back of the so-called *Washington Consensus* and the *End of History*. Their simplistic versions are that the neoliberal and market-oriented doctrines have already been proven as the only viable option for growth and that after the defeat of fascism and communism there is no alternative to them.

2.b.ii. *Thucydides Trap* and other IR theories about rising powers

Over two millennia ago, the historian Thucydides put forward a powerful idea: "what made war inevitable was the growth of Athenian power and the fear which this caused in Sparta" (Thucydides, 431BC). According to Allison, other observers identified several

> "causes of the Peloponnesian War. But Thucydides went to the heart of the matter, focusing on the inexorable, structural stress caused by a rapid shift in the balance of power between two rivals. Note that Thucydides identified two key drivers of this dynamic: the rising power's growing entitlement, sense of its importance, and demand for greater say and sway, on the one hand, and the fear, insecurity, and determination to defend the status quo this engenders in the established power" (Allison, 2017).

When the conflict between Corinth and Kerkyra (present Corfu) erupted, Sparta felt the need to defend its 2nd-tier ally Corinth, and Athens backed Kerkyra. Thirty years later, "Sparta was the nominal victor. But both states lay in ruin, leaving Greece vulnerable to the Persians" (Allison, 2017). And here lies the moral of the story: this is not about the inevitability of war, it is about needing to avoid the mistakes of history if one wants to avoid the same tragedies:

> "war between the USA and China in the decades ahead is not just possible, but much more likely than recognized at the moment. Indeed, judging by the historical record, war is more likely than not […] when a rising power is threatening to displace a ruling power, standard crises that would otherwise be contained, like the assassination of an archduke in 1914, can initiate a cascade of reactions that, in turn, produce outcomes none of the parties would otherwise have chosen." (Allison, 2017).

With the help of the Belfer Center, Allison developed an analysis of 16 historical moments when a ruling power was confronted with the rise of a powerful competitor (Figure 11). Two immediate conclusions can be drawn. One is that out of 16 cases, 12 resulted in war. The other is that if we look at the 20th century alone and exclude Germany's lapse of humanity, it becomes clear that war is not an inevitability.

Figure 11. Thucydides Trap case studies from Belfer Center

	Period		Ruling Power	Rising Power		Result
1	First half of 16th century		France	Hapsburgs		War
2	16th–17th centuries		Hapsburgs	Ottoman Empire		War
3	17th century		Hapsburgs	Sweden		War
4	17th century		Dutch Republic	England		War
5	Late 17th–early 18th centuries		France	Great Britain		War
6	Late 18th–early 19th centuries		United Kingdom	France		War
7	Mid-19th century		United Kingdom, France	Russia		War
8	19th century		France	Germany		War
9	Late 19th–early 20th centuries		Russia, China	Japan		War
10	Early 20th century		United Kingdom	United States		No war
11	Early 20th century		Russia, U.K., France	Germany		War
12	Mid-20th century		Soviet Union, U.K. France	Germany		War
13	Mid-20th century		United States	Japan		War
14	1970s–1980s		Soviet Union	Japan		No war
15	1940s–1980s		United States	Soviet Union		No war
16	1990s–present		United Kingdom, France	Germany		No war

Source: Belfercenter.org/ThucydidesTrap

Reflecting on the current rise of China, Allison argues that the rise is unavoidable and success in dealing with it requires mutual understanding:

> "The rise of a 5,000-year-old civilization with 1.3 billion people is not a problem to be fixed. It is a condition—a chronic condition that will have to be managed over a generation. Success will require not just a new slogan, more frequent summits of presidents, and additional meetings of departmental working groups. Managing this relationship without war will demand sustained attention, week by week, at the highest level in both countries. It will entail a depth of mutual understanding not seen since the Henry Kissinger-Zhou Enlai conversations in the 1970s. Most significantly, it will mean more radical changes in attitudes and actions, by leaders and publics alike, than anyone has yet imagined" (Allison, 2017).

Many IR thinkers believe that the Thucydides Trap is itself a trap, and criticize its proponents. Nye has argued that Allison misunderstands the Peloponnesian War and cites Kagan in arguing that there is no such *trap* even in the Peloponnesian, focusing instead on poor policy decision:

> "The Yale historian Donald Kagan has shown that Athenian power was in fact not growing. Before the war broke out in 431 BC, the balance of power had begun to stabilize. Athenian policy mistakes made the Spartans think that war might be worth the risk. Athens' growth caused the first Peloponnesian War earlier in the century, but then a Thirty-Year Truce doused the fire. Kagan argues that to start the second, disastrous war, a spark needed to land on one of the rare bits of kindling that had not been thoroughly drenched and then continually and vigorously fanned by poor policy choices. In other words, the war was caused not by impersonal forces, but by bad decisions in difficult circumstances." (Nye, 2017).

Holmes, a defense analyst for *The Diplomat* and Professor of strategy at the U.S. Naval War College, has written the influential article *Beware the "Thucydides Trap" Trap - Why the U.S. and China aren't necessarily Athens and Sparta or Britain and Germany before WWI* (Holmes, 2013). Another example is Palmer's *Oh God, Not the Peloponnesian War again* suggesting that it is time for the West to learn about Asian military materials, which are "far more geographically, culturally, and historically relevant to the continent that is defining the 21st century than dipping into Thucydides again" (Palmer, 2020). Others argue that the trap exaggerates the risk of war in the contemporary age: "The greater challenge facing China and the USA is to avoid falling into the 'Churchill trap'. That is, falling into a long-term confrontation by repeating the mistakes of the Cold War between the US and the USSR." (Yuan, 2018). Yuan proposes a model of co-ruling which is possible if the majority of "the small states have more than one indispensable demand and neither of the two superpowers can simultaneously meet all of them, then the two poles' foreign functions will be differentiated, which affords small countries with a motive to simultaneously accept the two superpowers' leadership*"* (Yuan, 2018).

Organski's *power transition theory* is another valuable IR contribution:

> "An even distribution of political, economic, and military capabilities between contending groups of states is likely to increase the probability of war; peace is preserved best when there is an imbalance of national capabilities between disadvantaged and advantaged nations; the aggressor will come from a small group of dissatisfied strong countries; and it is the weaker, rather than the stronger power that is most likely to be the aggressor" (Organski, 1958).

This theory was an important step forward because it moved away from international elements, looking into the domestic, and understanding power beyond the military.

From Waltz's realism, two strains of balance of power theory have been generated: offensive realism and defensive realism. The *Tragedy of Great Power Politics* (Mearsheimer, 2014) fathers the offensive realism and its argument is illustrated in the premonition that China and USA will eventually go to war. First, there are five assumptions: states are the key actors in the system, which is anarchic; all states have some offensive military capability, and some have a lot; it is impossible to know the intentions of other states with any degree of certainty; survival is the principal goal of states; and states are rational actors – they act strategically in pursuit of their goals. These assumptions lead to three resulting behaviors: states fear each other, although the level of fear varies from case to case; states understand it is a self-help world; and states attempt to maximize the amount of world power they control. Therefore, great powers have two ultimate goals: to become regional hegemons; and to make sure no other country dominates their region. Just like the American history is one of controlling the Western hemisphere and avoiding that any other power controls the Eurasian continent, Mearsheimer argues that China will attempt to control its region, push the USA out of East Asia, and interfere in the politics of Western hemisphere the way the USA interferes in Asia. He foresees that the USA will go to great length to limit China's hegemony in its region and most of the Chinese neighbors will adhere to the American game (except for Pakistan and North Korea). This will create a military tension with high potential for war, and neither economic interdependence nor nuclear power will attenuate this tendency decisively.

Mearsheimer's "is a realist perspective, it is not the realist perspective" (Kirshner, 2010). It is not only about interdependence and nuclear arsenal, but about empirical perception that, contrary to offensive realists, for defensive realists

> "anarchy encourages states to adopt defensive, moderate, and restrained behavior in most instances […] because expansion is self-defeating because it provokes counterbalancing behavior; conquest rarely pays; the offense-defense military balance often favors the defender and the defense over the offensive; and socialization and lessons from history teach states that maximizing power is pathological and results in self-encirclement, imperial overextension, and overstretch." (Lobell, 2016).

The (neo-)liberals treat peaceful change more effectively. Ikenberry argues that a liberal leader can create a peaceful international order if it is *"*successful in binding other powers in a constitution-like arrangement within the framework of international institutions*"* (Paul T. V., 2016). He believes in the potential for a liberal order in East Asia:

> "The American goal is not to prevent this growth in Chinese power and leadership, but to make sure it is not used to turn the region into a closed, illiberal Chinese sphere of influence. Overall, there are reasons for both the USA and China to restrain their geopolitical rivalry. They will surely struggle and compete, seeking to be the leading state in the region. But American efforts to contain China and China's efforts to push the USA out of the region will both be self-defeating strategies. The most optimistic vision of a peaceful rise of China and a managed USA-Chinese rivalry in Asia is one in which Beijing comes to see that the American-led liberal international order can help facilitate China's peaceful rise" (Ikenberry, 2014).

Paul is a prominent thinker of rising powers' accommodation and plays a *translator* role among the different sides of the debate. He argues that "though structural conditions can lead to conflict, proper synchronization of strategies for peaceful change by established and rising powers can mitigate the possibilities of violent conflict" (Paul T. V., 2016). He understands accommodation, not has a deep friendship or lack of competition, but as the rising power receiving status and perks associated with its rank, recognition of its sphere of influence and the avoidance of military challenge. He sees the realists ignoring the possibility that the dominant power may lose strength and "might not be able to achieve balancing or deterrence

continuously to prevent the rising power from emerging as a system-challenging lead actor" that focuses on the "dyadic interactions while ignoring third parties and their role" (Paul T. V., 2016). He prescribed a solution for both parties to embrace, and talks about four accommodation requirements: ideological, territorial, economic, and institutional […] with a lot of emphasis in graduality:

> "peaceful transformation is possible despite structural changes if the dominant status quo powers follow a mixed grand strategy that gives more or less equal weight to gradual accommodation and balance/deterrence against a potential challenger. The challenger must also hold a peaceful rise strategy and seek incremental, as opposed to rapid change" (Paul T. V., 2016).

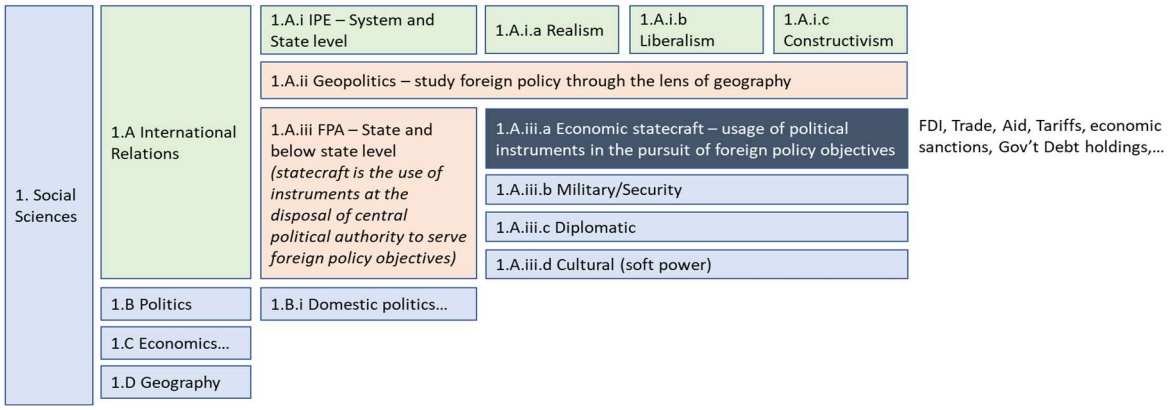
He fears that the USA is "unlikely to accommodate China fully unless it becomes a democratic state, a prospect that looks remote" (Paul T. V., 2016).

Luttwak was one of the first proponents of the *geoeconomics* concept. In *The rise of China vs. the logic of strategy* he warns China that the logic of strategy dictates that it could either pursue further economic prosperity or increased military strength, but not both objectives simultaneously. Alternatively, he suggested China could become a democracy in the Western sense: "Democratization would not suspend the logic of strategy that mandates growing resistance to growing power, but it would raise the culminating level of unresisted Chinese aggrandizement" (Luttwak, 2012). He anticipated a defensive geoeconomic strategy towards China and a trade war *avant la lettre.*

2.c. Geopolitics & Foreign Policy Analysis

Since there is no academic field map depicting the relationship among the topics covered by this thesis, Figure 12 has been specifically designed to this end. It starts from the macro-field Social Sciences on the left and gets subdivided towards the right. It also helps visualize what has been covered so far and provides a map for the rest of the section.

Figure 12. Relational map of the topics in Section 2



Source: By the author

Starting from what has already been discussed (in green), we have mentioned that this thesis lies in the IR field (1.A). It was also explained that IPE (1.A.i) studies IR at the system and state levels and presented its main branches (1.A.i.a-c). In this section, we cover geopolitics (1.A.ii) and FPA (1.A.iii), in orange. In Subsection 2.d we cover economic statecraft (1.A.iii.a) and its instruments.

Because this thesis falls into the FPA space, there is no need to explain why it needs to be analyzed. Geopolitics, on the other hand, requires contextualization and explanation of its relevance. For this author, geopolitics is the study of foreign policy through the lens of geography. It looks for geographical features, which are conceptually independent from the state as explanatory for the decisions made by actors in the name of states and other non-state actors. It is a fundamental explanatory variable for FPA, which, by definition, keeps foreign policy as the dependent variable needing explanation.

2.c.i Geopolitics

Geopolitics is the study of the changing world political map and the understanding of the "geo" dimension of the global, regional and state politics (Newman, 1998). It is "the analysis of the interaction between, on the one hand, geographical settings and perspectives, and, on the other, political processes" (Cohen S. , 2015). The geographical settings and the political processes are inter-constitutive among themselves. Gone are the years when geopolitics was a decadent subfield confined to the changes of territorial disputes and nationalist propaganda. In its post-modern face, geopolitics goes beyond the state and the territory and incorporates the dynamic forces of supra-national institutions and intra-national territorial ordering. Globalization forces change the functions of the state and join the strengthening of sub-state group identities to create a glocalization phenomenon, with global cities and *glocal* states (Hannay, 2008).

After the Cold War, the USA was in an uncontested dominant position with unparalleled economic, political and military power. Its hegemony was the first global leadership in the history, but, as Brzezinski foresaw, it was not sustainable. In the long run "the world politics is destined to become incompatible with the concentration of hegemonic power in the hands of a single state. Therefore, America is not only the first, or the only, truly global superpower; probably, it is also the last" (Brzezinski, 1997). As he famously put it, Eurasia is the center of the World and "he who controls Eurasia, controls the World".

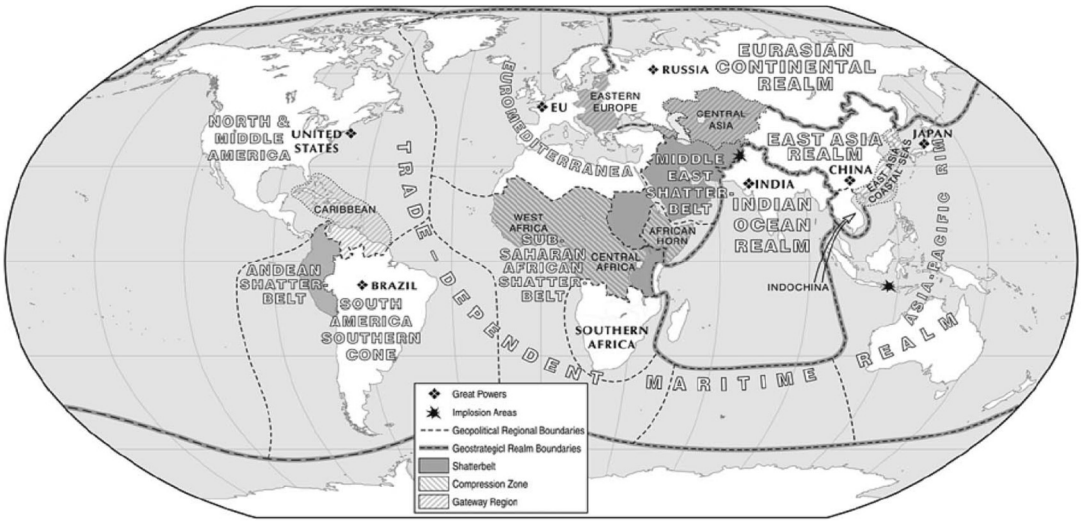
Even though the USA continues to be the strongest power across all dimensions, its influence is decreasing, particularly in Eurasia. With the integration of the EU, the rise of China and its own isolationist bias, we witness a radical geopolitical shift. China is leading a massive upgrade of the logistical and technological routes between the Atlantic and the Pacific via the Belt and Road Initiative (BRI), from which the USA is excluding itself. The analysis of COFDI cannot be alien to this paradigm shift.

When reflecting about the geopolitics of Eurasia, and the interconnection between China and Europe, it is informative to travel back 500 years and recall the geopolitics of Afonso de Albuquerque – the first Governor appointed by the Portuguese Empire to command the maritime commercial routes between Asia and Europe. In a decade, he secured control of the trade of Asian products, from the Persian Gulf to China, through an ambitious strategy of conquering the key points in the Indic Ocean (Garcia, 2017). The Strait of Malacca, conquered by Albuquerque in 1511, remains the ultimate maritime choke point, raising the importance for China to access the Indian Ocean by land. The recent connection through the Karakoram highway, to the port of Gwadar permits a direct route between Beijing and the Pakistan coast. Bab-el-Mandeb strait remains one of the most sought-after military stations in route to the Suez Canal, which explains why China established its first military base overseas in Djibouti, despite the proximity to the American, French and Japanese bases. Beijing-backed oil and gas pipelines in Central Asia allow for its energy imports from the Middle East to avoid the bottleneck in Ormuz. The conquest of Ormuz by Albuquerque in 1507 gave Portugal control over the Europe-India trade (Pelúcia, 2016). Another unavoidable historical archive is Marco Polo and *Pax Mongolica's* times: "it was trade routes, not the projection of power, that emblemized the Pax Mongolica. Mongol grand strategy was built on commerce much more than on war" (Kaplan, 2018).

Figure 13 displays one version of today's geopolitics, where the regions are the Maritime Realm, which encompasses North and Middle America (with the USA as its center), South America (with Brazil driving it), Maritime Europe and the Maghreb (where the EU is located, and Portugal within it) and the Asia-Pacific Rim (including Japan and Australia). The Eurasian Continental Realm consists of "the heartlandic Russian region, which extends into Belarus and eastern Ukraine" as well as Central Asia and the Transcaucasus (Cohen S. , 2015). The East Asian Realm is composed of China and Indochina, and south Asia stands out as an independent

region lead by India. The Middle East and Sub-Saharan Africa are shatterbelts (defined by the same author as "strategically oriented regions that are both deeply divided internally and caught up in the competition between great powers of the geostrategic realms").

Figure 13. Geopolitical world: Beginning of the twenty-first century



Source: (Cohen S. , 2015)

The American strategy for the Asia-Pacific Rim is to build up South Korea and Taiwan to protect Japan and contain China. Historically, China has focused more on its continental nature than on its maritime potential. Today, the central priority of the BRI is to extend influence on Pakistan, Central Asian and as much as possible westwards. What is recent is the enlargement of the maritime play to a more active dispute over the South and East China Seas, the launch of aircraft carries and the establishment of naval bases overseas (starting in Yemen). China's geographical distance and topography from the center to the outer regions (Tibet and Xinjiang) challenges territorial integrity. Taiwan, politically perceived as indivisible from the mainland, suffers growing tensions for definitive outcomes from both sides, with opposite objectives (reunification vs. independence). Maritime Europe lies within the western peninsular and insular reaches of Eurasia: "The idea of Europe embraces a geopolitical system that seeks to balance national interests with a unified economic, political and social framework, propelled by the freedom of movements and expression" (Cohen B. , 2014).

2.c.ii Foreign Policy Analysis

FPA focuses on the processes and outcomes of foreign policy and studies the external activities of states and other non-state institutions. Any means used to implement foreign policy are covered, including diplomacy, economic sanctions and other instrument of economic statecraft. FPA is actor-specific and investigates the motivations and behaviors driving decision-making. Allison defends the recognition of three approaches: *Rational Actor Model, Governmental Bargaining Model* and *Organizational Process Model* (Allison, 1971). The first is based on the rational-choice theory, takes the state as unit of analysis and presumes rationality. The second moves from the state as a monolithic entity and breaks it into multiple agencies or bureaucracies driven by the maximization of their sizes and budgets. The third focuses emphasis on the *standard of procedures* of each institution and argues that it is hard to behave outside them.

FPA is about state and below-state levels of analysis. It is concerned about the continuous interactions of individual actors within their context. Foreign policy is always the dependent variable. The analysis of actor-specific behavior is key to understanding COFDI and can inform broader macro considerations. Speculation about foreign influence on domestic politics is a serious matter and requires enunciation of the mechanism through which it travels across political/commercial actors. Therefore, this thesis is more about FPA than IPE. It is self-evident that domestic factors are drivers of foreign policy. Not even neo-realists defend that the system explains everything:

> "For many scholars, the most significant source of foreign policy is the domestic structure of the nature of the state political institutions, the features of society and the institutional arrangements linking the state and the society and channeling societal demands into the political system" (Alden & Aran, 2017).

It is important to mention the domestic constituencies of foreign policy, which drive democratic decision-makers beyond their accountability and responsibility. Public opinion, interest groups and the media are important, but so is public diplomacy, the process "whereby governments

by-pass their equivalents in another country and target the wider political process, including civil society" (Alden & Aran, 2017). Public opinion and media are concepts too familiar to justify an ontological review but interest groups are less familiar to the public:

> "There are three major ways for public opinion to exert an active influence over foreign policy: through populist political movements, whether parties or less structured demonstrations; in crises, through heightened awareness and direct pressure on politicians; and through preparation of full-time organizations" (Alden & Aran, 2017).

The organization of groups around common interests can range from episodic and amateur to extremely powerful and effective in pursuing long-term agendas. It is hard to achieve *active veto power,* in the sense of being able to force something onto a Government. It is easier to develop *negative veto power* capable of preventing or delaying change. Fukuyama enunciated a key variant of interest groups – the *distributional coalitions*. The same invisible hand which organizes individuals in the market by matching supply and demand also drives individuals to get organized in increasingly powerful coalitions to extract resources from the state.

Next, we assess how the main branches of IR are helpful in FPA. Starting with realism, it is possible to synthesize its assumptions about how the world works as *groupism* (humans face each other mainly as members of a group), *egoism* (self-interest drives political behavior) and *power-centrism* (power is the fundamental feature in politics). Moreover, the world is anarchical, and states are willing to use force to get want they want. It is tricky to put IR realism and FPA together because while IR realism searches for general rules to model and understand the world, FPA needs to inform decision-making in real situations: "aside from the admonition to study both realist theories and the specifics of contemporary foreign policy problems – and the unhelpful warning that this is in fact quite hard to do – what other concrete lessons can be taken?" (Wohlforth, 2012). The key to making realism (or any theory) useful lies in understanding that theories are contingent on the applicability of their scope conditions. For example, the *Power Transition Theory* from Organski and Gilpin is only a useful representation

of the world if the capabilities of the challenger are approaching that of the hegemon. It is the condition of (high degree of) anarchy, so important in IR realism that is very unlikely to be found in real world FPA. The usage of the traditional offensive realist logic for forecasting the diplomacy of an EU member, which is simultaneously bound by the EU framework and held accountable by informed citizens, is doomed to failure.

Liberalism highlights the importance of individual's ideas and institutions, which can have a direct impact on foreign policies. It puts the freedom of the individual at the heart of political development, together with the right and duty to treat everyone as ethical subjects. This tends to create a peace zone among liberal states but "aside from restrain in warring other liberal states, liberalism carries with a second effect – what David Hume called *imprudent vehemence*, or aggression against or enmity to non-liberals" (Doyle, 2012).

In line with this, Kant proposed three *definitive articles* which are necessary and together sufficient for peaceful coexistence: *republican representation* (and rule of law), *liberal respect* (including non-discriminatory rights) and *transnational interdependence*. Beyond those peace zones, and because we live in a nuclear world full of regional unstable balances, liberals should not embark on crusades for democracy, which can be suicidal (Doyle, 2012). Likewise, liberal states "should be prepared to defend and formally ally with authentically liberal democratic states that are subject to threats or actual instances of external attack or internal subversion" (Doyle, 2012). In this quest to preserve and expand the liberal peace zone, there is a debate about its meaning. Some ideas are generally consensual today: that inspiration (*City on the Hill*) is an important source of promotion through role-modeling; that expansion through military means tends to backfire; and that intervention (to defend the oppressed) is reasonable under extreme circumstances which are possible but hard to verify.

If realism bets too much on inevitability and liberalism promotes a peace zone among the liberal states but is attracted to conflict with the others, is constructivism a better advisor to FPA? First,

"constructivism has nothing substantial to say about who or what are the main actors, problems, or issues in IR […] offers no solution to specific problems […] nor does it prescribe any particular policy directions" (Flockhart, 2012). The reader may recall Wendt's description of constructivism to understand why it is frequently seen as a sort of empty vessel which only offers a social ontology. But for the author, constructivism upholds one of the key principles of proper FPA, which is that "the world is of our making" (title of Onuf's 1989 book), or as the title of Wendt's 1992 paper says, "Anarchy is *What States Make of It*". Constructivism refuses a world of necessary anarchy and self-help and postulates that state's identities and interests are (socially and intersubjectively) constructed. This is important because if states construct a world in which general behavior is of self-help, if and how can "we move from one culture to another?" (Flockhart, 2012). Constructivism believes in the normative power of institutions (such as the EU or NATO).

2.d. Economic Statecraft and Geo-economics

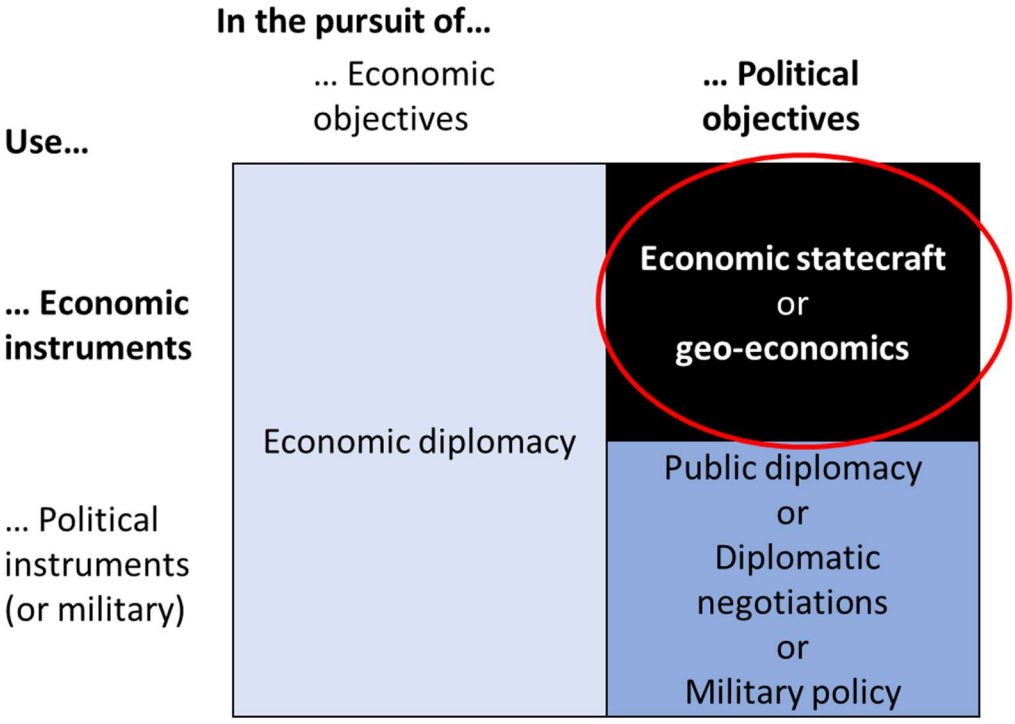
2.d.i Understanding Economic Statecraft and Geo-economics

Economic Statecraft, geo-economics and *economic diplomacy* are synonyms related to the object of this thesis (Figure 14). Economic statecraft refers to an effort by a sender state

> "to influence a target state either to do something it would not ordinarily do or forgo an action that it would otherwise engage in, by the manipulation of the market in a manner that provides economic benefits to states that comply and/or imposes economic penalties on those who fail to comply*"* (Blanchard & Ripsman, 2013).

Geo-economics is "the usage of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effects of other nations' economic actions on a country's geopolitical goals*"* (Blackwill & Harris, 2016). E*conomic diplomacy* is "the activities, regarding methods and process for international decision making, related to cross border economic activities, pursued by state and non-state actors*"* (Bayne & Woolcock, 2017).

Figure 14. Economic statecraft vs. Economic diplomacy



Source: By the author

Many authors understand economic diplomacy as broader than economic statecraft, adding the use of states' political influence to promote economic interests in international markets. This thesis privileges the first two expressions and understands them as the usage of economic instruments in pursuit of political or strategic objectives.

Baldwin is the precursor of the analysis of economic statecraft. Defining *statecraft* as "governmental influence attempts directed at other actors", he distinguishes four types: propaganda (manipulation of verbal symbols), diplomacy (negotiations), military statecraft, and economic statecraft. He divides economic statecraft instruments in positive or negative. While his list is regarded as too narrow, his division still holds. The positive are softer and more related to strategic engagement, such as investment guarantees, aid, direct purchases, subsidies to trade, granting licenses and most-favorable-nation treatment. The negative related to subversion and coercion, including embargoes, boycotts, tariffs, blacklists, license denials, freezing assets, expropriations, aid suspension, etc. (Figure 15).

Figure 15. Baldwin's instruments of economic statecraft

Examples of positive instruments of economic statecraft

Trade related	Capital related
Tariff discrimination (favorable)	Providing aid
Granting "most-favorable-nation" treatment	Investment guarantees
Tariff reduction	Encouragement of private capital exports or imports
Direct purchase	Taxation (favorable)
Subsidies to exports or imports	Promises of the above
Granting licenses (import or export)	
Promises of the above	

Missing foreign investments, both greenfield and capital

Examples of negative instruments of economic statecraft

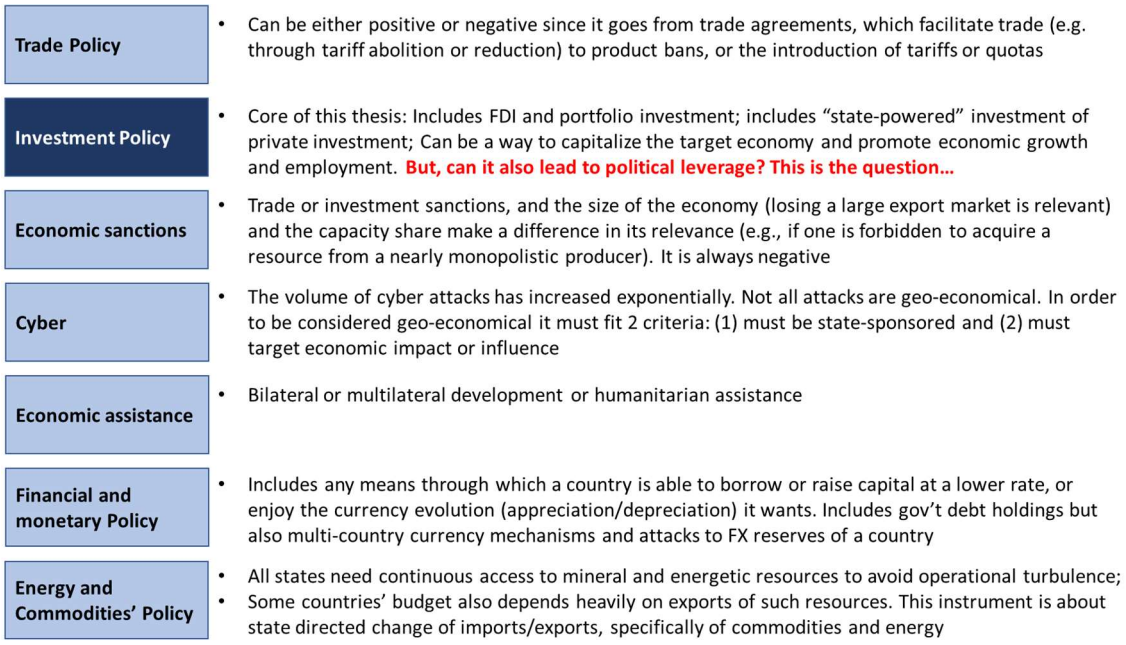
Trade related	Capital related
Embargo	Freezing assets
Boycott	Controls on import and export
Tariff increase	Aid suspension
Tariff discrimination (unfavourable)	Deprivation of ownership (expropriation)
Withdrawal of "most-favored-nation" treatment	Taxation (unfavorable)
Blacklists	Withholding due to international organization
Quotas (import or export)	Threats of the above
License denial (import or export)	
Dumping	
Preclusive buying	
Threats of the above	

Source: (Baldwin, 1985)

In our context, the most important pitfall of this original list is the omission of *state-powered* FDI: "The classification presented is obviously not comprehensive. One of the elements that must be added are foreign investments, both greenfield and capital. Nowadays, states, usually through state-owned entities such as SWFs or SOEs, invest abroad heavily" (Kamiński, 2017).

This thesis uses the list of instruments proposed by Blackwill & Harris (Figure 16): trade policy, investment policy (including *state-powered* FDI), economic and financial sanctions, cyber, aid, financial and monetary policy, and energy and commodities' policy.

Figure 16. Geo-economic instruments according to Blackwill & Harris



Source: By the author

Since this thesis focuses on the conversion of *economic power* into *political influence*, it is also important to clarify these two concepts. *Economic power* is one's wealth or the ability to produce, buy and sell a lot of products and services. *Political influence* is one's ability to impact a state's making and implementation of official policy decisions. Countless studies describe the usage of such levers as an old artefact still in use. Paul Kennedy wrote decisively that the main arguments of *The rise and fall of great powers* are that

> "There exists a dynamic of change, driven chiefly by economic and technological developments, which then impact upon social structures, political systems, military power, and the position of individual states and empire […] this uneven pace of growth has had crucial long-term impacts upon the relative military power and strategical position of the members of the states system […] the fact remains that all of the major shifts in the world's military-power balances have followed alterations in the productive balances […] victory has always gone to the side with the greatest material resources" (Kennedy, 1988).

It is relevant for this thesis that the mechanisms through which geo-economics is executed are often understudied and overblown. Coercing a commercial actor or a state to behave contrary to its interests is challenging. Later, this thesis reviews the literature about China's geo-economics and surfaces that "generally speaking, Chinese leaders prefer economic carrots to sticks as a means of exercising diplomatic influence" (Mingjiang, 2017).

There is a long academic debate about the effectiveness of economic statecraft (Blanchard & Ripsman, 2013). Two schools dominated the debate: the *commercial liberals*, arguing that economic statecraft can be very effective if well employed, and the *political realists*, defending that economic statecraft usually fails because what matters are the political not the economic imperatives. More recently, there emerged a third way, the *conditionalist school*, focusing on the conditions *under which* economic statecraft can be effective. At first, it focused on international environment conditions, but later incorporated domestic conditions. For a while, the models were too simplistic to explain the real world and could not evaluate the full breadth of economic statecraft tools with a unified model (e.g. distinguishing sanctions vs. incentives). Blanchard and Ripsman developed a conditionalist political theory of economic statecraft which solved multiple problems and is among the best in explaining short-term geo-economics (pursued for a clearly specified, relatively immediate policy change). An important shortfall which makes it only partially useful to us, is the lack of focus on long-term incentives, meaning

> "those inducements geared towards the transformation of the target state's interests, perceptions, or political coalitions without any clear short-term demand or well-defined long-term objectives. The logic of this exchange is not to strike a bargain with the target state, but to reshape its societal attitudes over time" (Blanchard & Ripsman, 2013).

This is problematic because China's economic statecraft is increasingly long-term focused, but the theory's reasoning is still valid. They regard economic sanctions as a "coercive strategy" and economic benefits as a "persuasive strategy". They exclude from economic statecraft initiatives that can be considered as economic warfare (e.g., arms embargoes) or social

sanctions (e.g., exclusion from international sports events). The theory predicts that economic statecraft can produce change in the target state's policies when they manifest themselves as political costs which outweight the political interest in the status quo. This suggests that the economic action cannot be assumed to translate into political costs – it only translates into political costs under certain international and domestic conditions. Moreover, an economic statecraft initiative only has impact if its cost outweights the cost of non-compliance. This model considers that the main goal of political leaders is to remain in power, and that, even when they have altruistic purposes, remaining in power is a pre-requisite. This theory recommends the quantification of two variables. The first is the *threat to strategic interests* (TSI), calculated as the difference between TSI of compliance and TSI of non-compliance. These are affected by several factors including the magnitude of the demands, the geopolitical pressure, the behavior of third parties, the external military or diplomatic pressure, etc. It considers that "economic statecraft frequently operates by mobilizing powerful interest groups" which pressure the state to comply with the demands.

The second is *stateness*, which measures the state's immunity to pressure from interest groups. It can be broken down into *autonomy* (to make decisions despite domestic opposition), *capacity* (to compensate or coerce opponents) and *legitimacy* (i.e., the ability to rally disaffected groups). The theory also shows that convincing the head of the state is a critical success factor and that economic statecraft can be effective under certain conditions, but it is not always the best option and in some situations it can be extremely ineffective. One common pitfall from commercial liberal advocates is to "treat the state as a black box, responding to economic stimuli in a uniform manner to maximize aggregate gains and losses". It affects interest groups differently, and not all groups have access to the state or can impose political costs.

This theory is informative to this thesis, despite not covering longer-term plays, nor covering China as a sender state or Portugal as a target state.

In Chapter 5, we look deeper into economic statecraft theories by analyzing the Chinese practices. For now, we move onto the debate about the goodness of economic statecraft, which has been used throughout the centuries by everyone, including the Western liberal democracies. According to Zoellick, former U.S trade representative and WB president, "separation of economics from USA foreign policy and security policy reflects a shift from earlier American experience. For its first 150 years, the American foreign-policy tradition was deeply infused with economic logic*"* (Zoellick, 2012). More recently, it has been ideologically dismissed particularly in the West. The phenomenon in the USA can be explained by the

> "lack of presidential leadership that has spanned both parties; the dominance of economic sanctions as the near reflexive geoeconomic instrument of choice; and difficult bureaucratic politics, reflected in the steady migration of geoeconomic decision making away from the State Department and those responsible for placing U.S foreign policy interests above all others" (Blackwill & Harris, 2016).

Those authors blame "a faulty historical memory" and present multiple episodes of American geo-economics organized in three periods: pre-war, interwar, and postwar (the golden age of American geo-economics). They argue that Kennan, the creator of the containment doctrine, was disappointed to see his creation gradually converted into military intervention.

With Obama, economic statecraft was upgraded to a pillar of foreign policy (Obama, 2013).

This volatility around the perception of the goodness of economic statecraft is linked to the relative power of two schools of thought: the *neoclassical economists* and another group which could be called *geo-economics interventionists*. The first is stereotyped as postulating that economics and politics need to be separate, distinct, and autonomous spheres of social life, and the second as emphasizing the role played by states in private markets to pursue their agenda:

> "As the cold war came to an end, the orthodoxy of neoclassical economic thought persisted, as did the resulting divides between foreign policy thinkers and neoclassical economists (who continued to hold economics and markets as a realm to be kept free from geopolitical interference) […] any meaningful attempt to return geoeconomics to a considered place within U.S. foreign Policy must reexamine the most basic

> assumptions and think outside the bounds of […] deeply established disciplinary conventions" (Blackwill & Harris, 2016)

Adam Smith anticipated that the goodness of a neighbor's riches depends on the current politics:

> "The wealth of a neighboring nation, however, though dangerous in war and politics, is certainly advantageous in trade. In a state of hostility, it may enable our enemies to maintain fleets and armies superior to our own; but in a state of peace and commerce it must likewise enable them to exchange with us to a greater value*"* (Smith, 1811).

All in all, the point is that "the end of the cold war has led to an increase in sanctions, but not necessarily in their relative effectiveness", conversely "the positive use of economic incentives has considerable promise as an instrument of statecraft and deserves more systematic attention in the study of foreign policy" (Mastanduno, 2012). In Chapter 5, we will see that there are different tactics of positive economic statecraft. For now, it is sufficient to distinguish tactical linkage vs. structural linkage. The first is about giving away with the expectation of concrete concessions, and the second is about long-term engagement through a continuous flow of incentives which change the balance of interests in a country. Remembering constructivism, this is using economic interdependence to change a target country's identity, interests and eventually its behavior. And what does liberalism and realism think of economic statecraft?

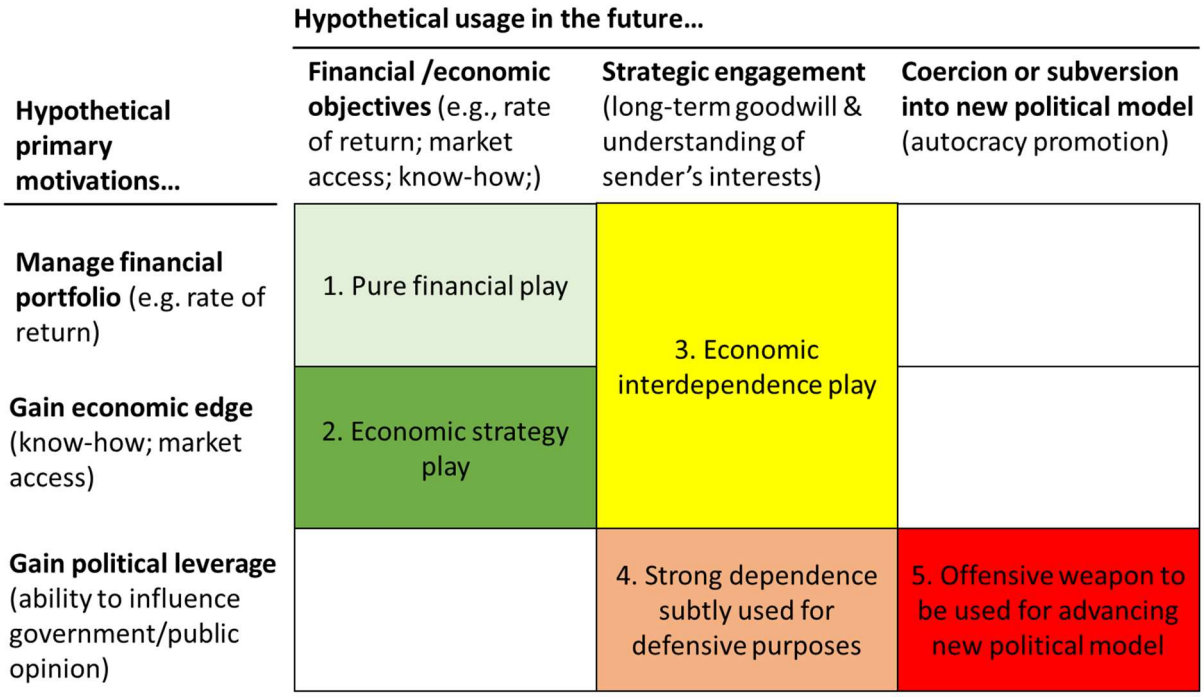
> "liberals argue that economic interdependence decreases incentives for conflict by tying peoples more closely together and increasing the costs of economic disruption […] realists, in contrast, generally argue that economic interdependence is more likely to lead to state conflict.*"* (Mastanduno, 2012).

In line with the realist view, in *Connectivity Wars,* Leonard argues that "the very things that connect the world are now being used as weapons" (Leonard, 2016).

2.d.ii Five hypothetical "plays" of economic statecraft

Now that the reader has been exposed to the basics of IR, FPA, geopolitics and economic statecraft, it is time to introduce a framework (by the author) which organizes hypothetical motivations and usages of economic statecraft in a matrix and identifies five possible "plays" (Figure 17). The illustration is skewed towards "investment" instruments, but the logic applies to other instruments.

Figure 17. Five hypothetical "plays" of economic statecraft



Source: By the author

The Y-axis organizes the cases based on the hypothetical primary motivations of each investment. *Manage financial portfolio* fits if an investment is executed primarily in pursuit of financial benefits. *Gain economic edge* applies if an investment is executed with the primary objective of acquiring previously unavailable competences or resources, such as technological or regulatory know-how, accessing new markets, securing critical inputs, acquiring better branding, etc. *Gain political leverage* relates to investments driven by their political influence

potential. These tend to be controlling stakes in *sensitive assets* or *strategic sectors* (e.g., energy distribution or logistics infrastructure, media companies, banks).

The X-axis assesses the owner's willingness to use them for influence purposes. *Financial /economic objectives* apply to investments that are not expected to be used in the future for political advantage, besides improving the financial/economic position of the acquirer. *Strategic engagement* applies when the buyer is presumed to want to use the ownership as a source of relevance (or leverage), increasing the goodwill from the target state and hoping that interdependence raises the costs of political tension. It has a defensive logic. *Coercion or subversion into a new political model* applies if it is presumed that the investor intends to use the ownership as an instrument for subversion or coercion in pursuit of political change. It has an offensive logic.

This matrix has nine combinations, but only five are reasonable *plays*: two were merged into one play and three combinations are disregarded since they are contradictory (e.g., it is absurd that someone acquires a target with the motivation of using it for political leverage and simultaneously not having political leverage as a hypothetical usage).

The five reasonable "plays" are labelled and illustrated with hypothetical cases:

1. Pure financial play – to invest in a company because the expected financial return compensates for its risk profile. An American pension fund can acquire 10 percent of a Portuguese utility simply for expecting a safe return. This presumes that the investor cannot introduce its operatives in the company.

2. Economic strategy play – to acquire a relevant stake in a company to accelerate the sender's growth. This generally means getting access to technological or regulatory know-how, new markets, institutional credibility, or critical supplies. The percentage of ownership is secondary. Illustrative scenario: an American fund may acquire a minority stake in the Portuguese utility

to learn about energy market developments in Mozambique, where its other portfolio companies may want to operate.

3. Economic interdependence play – investments expected to provide relevant financial/economic returns but also strongly endorsed (or financed) by the sender state to increase the economic interdependence with the target state. These are not expected to be called upon for political leverage, but the buyer is aware of the political goodwill being acquired. Illustrative scenario: an American pension fund investing EUR 50Mn for 50 percent of an industrial greenfield in the surroundings of Havana two years after the end of the American embargo.

4. Strong dependence subtly used for defensive purposes – investments not driven by economic benefits and but rather by their defensive political leverage. The intention is to use the vehicle to defend the sender country from criticism regarding its political model, but not to use the investment as a vehicle of change of the target country's political model. These investments tend to be controlling stakes in strategic or sensitive assets which provide diplomatic relevance through their mere existence, and increase the economic interdependence. They are not meant to imprint explicit aggressiveness (i.e., blackmailing). Illustrative example: a Russian conglomerate controlling the largest Portuguese airport concession company (ANA) and the largest utility company (EDP) simultaneously. These assets cannot be "moved out" out of Portugal, but they can silently increase the *context costs*. In the event of an obvious boycott, these assets can be nationalized by the Portuguese government (with severe public image implications). The key point is that there is a grey area where damage exists but is not tangible enough to legitimate governmental intervention. The title of this category refers to *subtle use for defensive purposes* (such as the potential usage for subtly influencing the media). Through the ownership of a controlling stake in large domestic enterprises, a Government can hypothetically approach the Portuguese newspapers with an upgraded monthly sponsorship

allowance. To give a sense of proportion, the total governmental support to media during the COVID-19 crisis in Portugal, was EUR 11.25Mn (Diário_da_República, 2020). Portugal is a first-world country and there is no amount for which a foreign Government could acquire all-encompassing control over the media. But avoiding front pages about a specific scandal, through a EUR 2Mn increase in public relations (PR) budget, is not unrealistic. Journalists in countries like Portugal are a fascinating values-driven class which upholds its independence as an absolute. But done subtly, such defensive influence exists.

5. Offensive weapon to be used for advancing new political model – investments executed precisely because they increase the political leverage over a country and are intended to be used as either coercive of subversive tools (i.e., beyond strategic engagement and beyond subtlety). Illustrative scenario: Auto Europa (a Portuguese large auto part manufacturer with 5800 employees) was owned by an American Fund, and an American representative would meet with the Government threatening to close the factory if Portugal acquired Huawei's 5G core network equipment. This play is a type of economic warfare, or even political warfare (which is covered in Section 5).

The next section searches for theoretical backing of autocracy (and democracy) promotion, keeping in mind the difference between the 4th and the 5th plays.

2.e. Foreign clout in regime evolution

2.e.i. Four important concepts in foreign interventionism

Before reviewing what is known about foreign interventionism it is important to introduce four concepts: *coercion, subversion*, *soft power*, and *smart power.*

Coercion is "the ability to get an actor – a state, the leader of a state, a terrorist group, a transnational or international organization, a private company – to do something it does not want to do" (Art & Greenhill, 2018). It works through threats (implicit or explicit) and/or actions, usually involving the military: "Coercive action may also utilize positive inducements. Offering such inducements may increase chances of success, but coercion is not coercion if it consists solely of inducements" (Art & Greenhill, 2018). Coercion is hard and generally ineffective because it requires the target to lose face, implies a loss of power, and creates precedence for repetition. Economic sanctions, such as trade limitations, investment prohibitions, or financial movement restrictions are coercive tools. In terms of effectiveness

> "economic coercion works better at the threat stage than at the imposition stage… more likely to produce concessions when the target's costs of sanctions imposition is significant, when the sender's costs are minimal, when the issue under dispute is of low salience to the target country, when the sender and the target are closely allied, when an international institution endorses the sanctions, and when the target state (as well as the sender) is a democracy.*"* (Drezner D. , 2020).

Drezner's findings suggest skepticism about the effectiveness of economic statecraft as a source of coercion from an autocracy onto a western liberal democracy.

Subversion can be defined as "actions designed to undermine the military, economic, psychological, or political strength or morale of a governing authority" (DOD, 2014). It is

> "a secret reaction/action against existing rules and norms either by ignoring, violating or seeking to change them, or trying to preserve stability by secretly resisting new political or management initiatives, which are perceived as a threat to certain values, norms and interests." (Olsson, 2015).

In liberal democracies subversion can have several faces, such as

> "whistle-blowing by a committed public official to make the media aware of dubious government activities like environmental destruction; secretly coordinated exit by disappointed professionals in order to leave *their organization* in a troublesome situation; a tacit agreement to slowdown in professional activities by a staff who dislike a new management initiative; a top-manager attempting to saw dissent between political parties to be able to divide and rule on important issues; and a government trying to secretly violate legal rules in order to increase arms export." (Olsson, 2015).

These examples reflect the phenomenon as being secretive, tactical, power-driven, applicable to different levels of relevance, and motivated by a subjective ambition to make things *better* (Olsson, 2015). *Better* because they are perceived as benevolent by some agents and malign by others. The USA Government shares Olsson's definition and categorizes subversion in types: "(1) establishing front groups, penetrating, and manipulating existing political parties; (2) infiltrating armed forces, the police […]; (3) generating civil unrest through demonstrations, strikes, boycotts" (Rosenau, 2007). About the front groups, it adds that "working in and through existing organizations, which provide a façade of legitimacy […] can bolster political allies, attack government policies, and attract international support" (Rosenau, 2007).

Coercion and subversion are very aggressive and not sufficient as instruments of persuasion among states. This applies to Western sender states and autocracies alike. Political parties and activist groups can play a role, but we need to look further to find useful theoretical background for economic statecraft as an instrument of political influence.

Nye fired an interesting debate about what constitutes effective power projection. He explains his concept of (co-optive or) *soft power* as "when one country gets other countries to want what it wants" which is contrasted with the hard (or command) power of "ordering others to do what it wants" (Nye, 1990). It rests mostly on a country's culture, its political values, and its foreign policy. Military and economic power are not alone as sources of power. In *Soft Power: The Means to Success in World Politics* (2004) he introduces the concept of *smart power*, which is

the effective combination of hard power with soft power strategies. In *Future of Power (2010),* he wraps everything up in a visual manner. Power is the ability to influence the behavior of the opponent to achieve the desired outcome and power is distributed in the world as if in a three-dimensional chessboard with the military on the top, economic relations in the middle, and transnational relations (things that cross borders outside the control of governments, like pandemics and climate change) at the bottom. While the USA dominates the top board, it faces large contenders in the middle (e.g., the EU, China and Japan). The bottom board is chaotic. For him, labelling this picture as unipolar or multipolar is a mistake because these concepts are senseless in the bottom board and in the overall picture. Powers are resources available and what matters is the ability to convert them into desired outcomes. A successful strategy combines different resources (soft + military + economic power) and selects means wisely (e.g., coercion, subversion, rewards, attraction). Power is more than "getting people or groups to do something they don't want to do", and there are three faces of relational power: commanding change, controlling agenda and establishing preferences:

> "the ability to command others to change their behaviour against their initial preferences is one important dimension of relational power but not the only one. Another dimension is the ability to affect others' preferences so that they want what you want and need not command them to change". (Nye, 2011).

Nye recommends a new IR synthesis – *liberal realism* –, which distinguishes power *with other* states from power *over other* states. For him, the realism-idealism dichotomy is overstated, since realists can acknowledge "the importance of ideal and values, and idealists do not necessarily reject all geopolitical restrains". Perhaps the global (dis)order became too complicated to be evaluated in polarity terms and China cannot hold enough economic power in Portugal to coerce it. Likewise, it may be a stretch for the USA to limit the economic interdependence between Portugal and China based on subversion fears. But the right mix of economic and soft power may drive Portugal's interests closer to China's preferences.

2.e.ii. Five ideas to retain about foreign interventionism

Foreign interventionism literature provides five main insights to this thesis:

1. The concepts of autocracy vs. democracy are not binary, and illiberalism is one of the alternatives in between. Political scientists believe in sequential waves of democracy/ autocracy, and that their promotion is frequent, sometimes simultaneous.
2. In defining and labelling the diffusion of policy decisions within states, the strictness of the definition matters: *promotion* differs from *support*; *inclusive* differs from *exclusive* promotion; and political *influence* is not the same as political *interference*.
3. Democracies have actively promoted democratization abroad, but they have also supported several autocracies. And forcible democracy promotion (through military means) is not consensual in democracies.
4. Understanding regime promotion requires understanding their motivations, intentions, and instruments, for which comprehending the role of (local) elites is key.
5. Not all autocracies perform political interventionism equally: Russia, Venezuela, and Iran's autocracy promotion is different from China's quest for influence.

Regarding point 1, some define autocratization as "substantial de-facto decline of core institutional requirements for electoral democracy", where democracy is defined as "clean elections, freedom of association, universal suffrage, an elected executive, as well as freedom of expression and alternative sources of information" (Lührmann & Lindberg, 2019). If democracy promotion "aims to advance democratic processes from the outside", then autocracy promotion "refers to the phenomenon of political actors' attempts to consciously support autocratic regimes from the outside or to slow down processes of democratization in transformation countries" (Kästner, 2019). Many political scientists believe in the existence of a sequence of waves of democratization and autocratization, and that both "processes occurred cumulatively over the course of the twentieth century and were not purely domestic, but rather

externally affected processes" (Kästner, 2019). Huntington identified three waves of democratization and two of reversals (Huntington, 1991). Regime evolution is not a binary phenomenon and evolves over time (Lührmann & Lindberg, 2019).

The same author concludes that the third wave of autocratization (happening now) has a legal façade, since autocratization is gradually achieved through the erosion of the democratic processes, not abruptly and not by visible force. Vanderhill wrote decisively about this:

> "Many states are neither fully democratic nor fully authoritarian. The democratic transition literature implies that only democracy or authoritarianism is the equilibrium point where regimes will be stable. The existence today of numerous regimes that fall between these two points (such as Ukraine) challenges this assumption. Due to the lack of a common nomenclature, scholars have used terms such as *pariah regimes*, *hybrid regimes*, *grey zone, electoral democracy, competitive authoritarianism, pseudo democracy, electoral authoritarianism,* and *in-between."* (Vanderhill, 2013).

These regimes *in the middle* have regular elections "but lack rule of law, separation of powers, and protection of some basic civil liberties, such as freedom of the press*".*

Not only autocracies get involved in other country's domestic politics. Selecting just one classical source of subversion - *meddling in foreign elections* - Chomsky argues that

> "the world must be astonished — if they are not collapsing in laughter — while watching the performances in high places and in media concerning Russian efforts to influence an American election, a familiar US government specialty as far back as we choose to trace the practice. There is, however, merit in the claim that this case is different in character: By US standards, the Russian efforts are so meagre as to barely elicit notice." (Chomsky, 2017).

Blum, another Foreign Policy critic, points out that since the end of World War II, the USA has

> "1) endeavored to overthrow more than 50 foreign governments, most of which were democratically elected; 2) grossly interfered in democratic elections in at least 30 countries; 3) attempted to assassinate more than 50 foreign leaders; 4) dropped bombs on the people of more than 30 countries; 5) attempted to suppress a populist or nationalist movement in 20 countries*."* (Blum, 2013).

Levin, a researcher from Carnegie Mellon, published an account of all known election-meddling actions by the USA and USSR/Russia, from 1946 until 2000. Levin counts 36 cases for Russia/USSR and 80+ for the USA. Two in each three being covert. For multiple occasions in Italy, Greece, and Chile, the USA and the USSR interfered simultaneously. Moreover, the democratic intervener (USA) has not

> "limited its electoral interventions only to new democracies and/or *electoral authoritarian* regimes. Even according to very strict and conservative definitions of what a fully consolidated democracy is (agreement by multiple democracy measures, etc.), at least nineteen cases of such American interventions had occurred in such regimes. Examples in PEIG include Great Britain in the late 1980s, Costa Rica in the mid-1960s and mid-1980s, Israel in the 1990s, Italy in the late 1950s to the mid-1980s, Chile in the 1960s, Iceland in the mid-1950s, and so forth […] other democratic great powers (such as Britain and post-WW2 Germany) have also been quite willing to electorally intervene in elections in other established democracies." (Levin, 2020).

Levin details multiple case studies, offering insights about the methods used, which include but are not limited to "covert funding of the assisted side, dissemination of *scandalous* information on *undesired side*, pre-election public threats and promises, provision of increased monetary assistance" (Levin, 2020). Campaign funding is a crucial mechanism for foreign meddling and the "analog" methods for transferring funding still exist and involve

> "the arrangements of secret meetings between the trusted representatives of the intervener and the client in which bags full of physical copies of the local currency are transferred. The other requires finding suitable 'cutout' local firms or private businessmen which can be trusted by the client to accept these funds from a foreign power in some manner (directly or via 'padded' contracts) and then 'launder' them as 'legitimate' domestic donations to the client's election campaign" (Levin, 2020).

Levin explains that cryptocurrencies created a digital alternative flow which

> "eliminates the need for either a trusted intermediary or a physical meeting in order to transfer the covert campaign funding. It just takes a secret agent to enter the target country with a thumb drive filled with the needed units of the cryptocurrency […] buy a new laptop from a local computer store with cash, use it to connect to the free internet

> at a local coffee shop, and then use this connection to transfer the cryptocurrency in question to the preferred side's campaign*"* (Levin, 2020).

About the Russian interference in the 2016 election, Senator Rand Paul said that "the Russians are going to spy on us, they do spy on us, they're going to interfere in our elections. We also do the same [...] We all do it. What we need to do is make sure our electoral process is protected". Beinart from *The Atlantic* wrote that, in 1983,

> *"*Reagan created the National Endowment for Democracy (NED), which—by giving grants to "political parties, trade unions, free markets and business organizations, as well as the many elements of a vibrant civil society"- does openly what the CIA once did in secret.*"* (Breinart, 2018).

When Clinton was asked about USA influence in Israeli elections he replied: "That would be fair to say. I tried to do it in a way that didn't overtly involve me." (TOI_Staff, 2018).

To finalize, Burnell synthesizes the logic of democratic promotion in four steps:

> "(i) Idealism – a sense of moral or other responsibility to advance a cause whose principles are believed to be best for everyone;
> (ii) The claim that democracies do not make war on other democracies;
> (iii) Democratization removes those wellsprings of international terrorism that lie in political oppression and an unfree society;
> (iv) Democracy is good for national economic development. The development of other countries can be advantageous for prosperity in the established democracies or at least should reduce the necessity and cost of providing foreign aid." (Burnell, 2010).

Regarding point 2, an *inclusive* definition of autocracy promotion encompasses all external initiatives: "the deliberate actions of external actors […] may be but a small part" and these work by making "the international environment more hospitable to authoritarian or would-be authoritarian rules and regimes" (Burnell, 2010). Alternatively, "*less inclusive* definitions of autocracy promotion focus more on agency of actors and their intentions". Tansey argues for strict definitions requiring "a clear intent on the part of an external actor to bolster autocracy as a form of political regime as well as an underlying motivation that rests in significant part on an ideological commitment to autocracy" (Tansey, 2016). He suggests four dimensions for

evaluating the *degree of promotion*: "(1) the presence or absence of agency; (2) the intended target of the policy in question; (3) the underlying motives behind the policy; and (4) the effects of the policy*"* (Tansey, 2016). Others proposed different typologies, such as distinguishing between "foreign interference (activities that are unwelcome, covert, and coercive) and foreign influence (activities that are unwelcome, but nonetheless legal)" (Clarke, Hunt, & Sussex, 2020). Avoiding the legalist debate, the assessment is possible based on "the extent to which they impact political actors either directly or indirectly". Deliberate and targeted efforts to change the calculus of political elites to undermine a nation's sovereignty in the short term are *interference*. Broader information campaigns gradually affecting the perceptions of citizens or elites are longer-term *influence*. Yakouchyk distinguishes active from passive promotion:

> "The former is defined as deliberate actions undertaken with a view to weaken another country's liberal performance, or to strengthen the survival capacity of authoritarian rulers. Passive autocracy promotion is the 'support of an authoritarian regime through increasing economic and financial ties, and diplomatic support' without the intentionality to strengthen certain regimes, whereas the regime outcome in this case is a side-effect of pursuing economic interests." (Yakouchyk, 2018).

Regarding point 3, many scholars have studied democratic support for autocratic regimes:

> "The traditional assumption that democracies promote democracy has been challenged by recent studies. For example, Sean Yom and Mohammad Al-Momani (2008), Brownlee (2012), Thomas Ambrosio (2014), and Tanja Börzel and Vera Van Hüllen (2014) provide convincing arguments of how established democracies can act as *black knights* and support authoritarian regimes, preventing their collapse if it is beneficial for their strategic goals." (Yakouchyk, 2018).

Nevertheless, American backing of autocratic regimes is less frequent than it used to be (Robinson, 2013). The hottest debate about democratic promotion is perhaps about how the *Democratic Peace Research* program (an influential strand of IR theory) has been legitimizing *liberal interventionism*, more concretely its role in supporting "the belligerent behaviour of democratic states during the so-called *War on Terror*, and the use of its findings to justify the

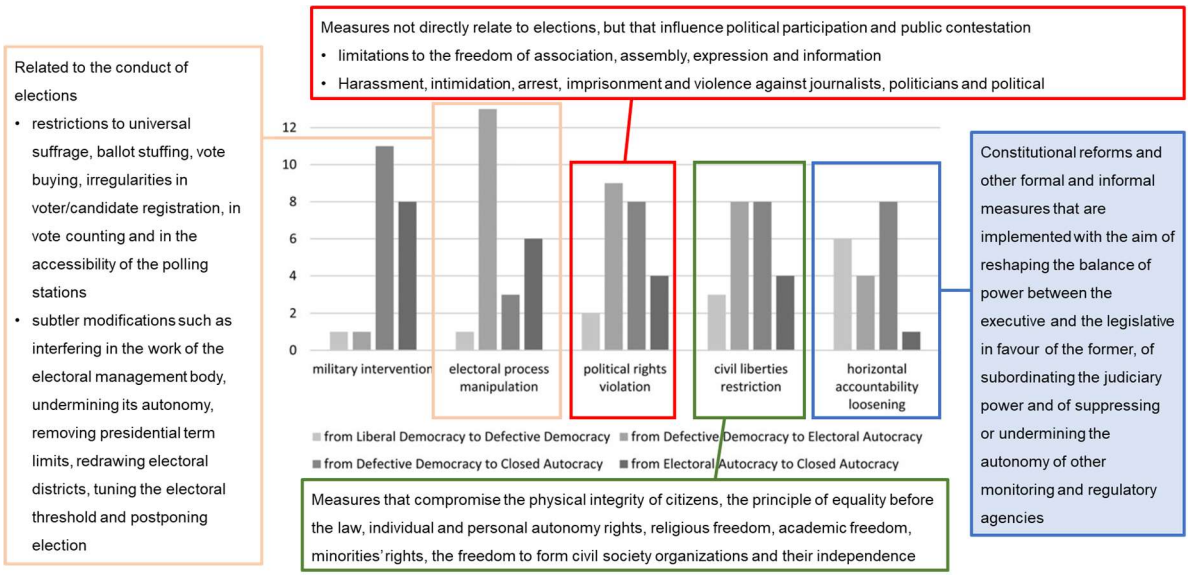
US led invasion of Iraq" (Hobson, 2011). Its critics present ethical and empirical arguments. On the ethical side, they argue with *Hamilton's skepticism* against *Kantian optimism*:

> "Have republics in practice been less addicted to war than monarchies? Are not the former administered by men as well as the latter? Are there not aversions, predilections, rivalships, and desires of unjust acquisition, that affect nations, as well as kings? Are not popular assemblies frequently subject to the impulses of rage, resentment, jealousy, avarice, and of other irregular and violent propensities?" (Hamilton, 1787).

Empirically, they argue that "in the short term, democratic intervention appears to be successfully promoting democratization, but the target states tend to end up among the unstable semi-democracies." (Gleditsch, Christiansen, & Hegre, 2007). There is a growing consensus in the literature that "authoritarianism per se is not an explicit goal of illiberal powers, and what has been labelled as autocracy promotion does not replicate the concept of democracy promotion with its clear normative underpinnings." (Yakouchyk, 2018).

Regarding point 4, we start with Cassani & Tomini's empirical study (Figure 18) which identified five modes of autocratization and quantified them in 46 autocratization cases.

Figure 18. Autocratization forms by period



Source: Based on (Cassani & Tomini, 2019) figures and definitions

Each bar counts the cases in each of the stages of autocratization, for each of the five modes (there is more than one mode in several cases). *Horizontal accountability loosening* stands out

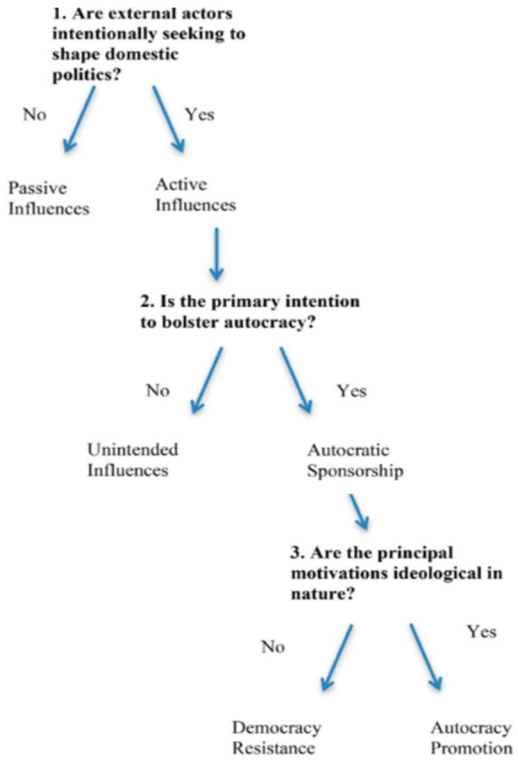
as the most frequent mode in moving from a *liberal democracy to a defective democracy*, and *electoral process manipulation* is the most frequent mode to move from a *defective democracy to an electoral autocracy*. Maintain tight horizontal accountability is, therefore, the first line of defense, and governmental influence over the *checks and balances* (i.e., the Judiciary, the Central Bank, the Court of Auditors and regulators) is a sign of alert to look for.

For COFDI to be actively used in a #5 type of *play* it must enable one of the four modes: *electoral process manipulation, political rights violation, civil liberties restriction, or horizontal accountability loosening*. It is obvious how control over the media or financing political parties may enable some of these modes, but it requires further explanation to postulate how foreign ownership of a company can be instrumental for that. As Levin explains, corruption, media control or shady party financing can help an aspiring autocrat to gain political leeway, but is FDI an enabler of that? Does it make it legal (i.e., turning *interference* into *influence*) or just more opaque?

Tansey clarifies that "intentions and motives are related, but not the same. Intentions concern the purpose of the policy – what is it intended to achieve", whereas "the underlying motives behind such an intention, however, may be diverse, and the goal of sponsoring autocratic regimes may be pursued for a variety of reasons: ideological or strategic, altruistic or self-interested" (Tansey, 2016). For him, there are three main motivations to support autocracy. The first two rest on instrumental self-interest: fear of democratic transition as a threat to political authority and protect authoritarian regimes abroad to ensure that supportive and compliant allies remain in power. The third motivation rests on ideological commitment: "to shore up and support autocratic elites abroad, namely an ideological commitment to authoritarianism as a form of regime type" (Tansey, 2016). He argues that autocracy promotion presupposes "a clear ideological commitment to promote a particular, nondemocratic regime type" (Tansey, 2016).

This scholar illustrates well how intentions and motivations help determining which type of international influence on autocracy is present in each case (Figure 19).

Figure 19. Typology of international influences on autocracy



Source: (Tansey, 2016)

Vanderhill brings from democracy promotion theory the focus on elite behaviors and assumes them as "rational individuals who seek to maximize their own interests" and "desire either to maintain power or, if out of office, to obtain power" (Vanderhill, 2013). External actors encourage authoritarianism by: (1) changing elite's strategies or (2) their capabilities. In the first, external actors influence the acquisition of power in three ways

> "demonstration effects ([…] where elites adopt strategies because they are seen as effective solutions to their problems […]), purposive and collaborative action by external 'change agents' ([…] involve non coercive active collaboration with elites in the recipient state […]), and pressure ([…] the external actor will apply positive and negative incentives to encourage, or even force, elites to change strategies)" (Vanderhill, 2013).

In the second, there are four types: "provision of technical and financial assistance for political parties, assistance for civil society, overall economic assistance, and assistance for repression"

(Vanderhill, 2013). Democracy and autocracy promotion have their differences. Democracy promotion also aids political parties ("not usually financially"), civil society, and economic stability. However, "democracy promotion efforts, at least as undertaken during the past two decades, do not provide aid for repression. Second, a significant way of increasing democratic elite capabilities is through election monitoring" (Vanderhill, 2013).

Schedler published a *menu of manipulation*, through a metaphorical "chain of democratic choice" (Figure 20), where the integrity of the regime requires all steps to be kept unviolated.

Figure 20. Chain of democratic choice & the menu of manipulation

	Dimensions of choice	Normative Premises of Democratic Choice	Strategies of Norm Violation
1	The object of choice	*Empowerment:* Democratic elections involve the delegation of decision-making authority.	• *Reserved positions:* limiting the scope of elective offices • *Reserved domains:* limiting the jurisdiction of elective offices
2	The range of choice	*Freedom of supply:* Citizens must be free to form, join, and support conflicting parties, candidates, and policies.	• *Exclusion of opposition forces:* restricting access to the electoral arena • *Fragmentation of opposition forces:* disorganizing electoral dissidence
3	The formation of preferences	*Freedom of demand:* Citizens must be able to learn about available alternatives through access to alternative sources of information.	• *Repression:* restricting political and civil liberties • *Unfairness:* restricting access to media and money
4	The agents of choice	*Inclusion:* Democracy assigns equal rights of participation to all full members of the political community.	• *Formal disenfranchisement:* legal suffrage restrictions • *Informal disenfranchisement:* practical suffrage restrictions
5	The expression of preferences	*Insulation:* Citizens must be free to express their electoral preferences.	• *Coercion:* voter intimidation • *Corruption:* vote buying
6	The aggregation of preferences	*Integrity:* One person, one vote. The democratic ideal of equality demands weighting votes equally.	• *Electoral fraud:* "redistributive" election management • *Institutional bias:* "redistributive" electoral rules
7	The consequences of choice	*Irreversibility:* Elections without consequences do not qualify as democratic.	• *Tutelage:* preventing elected officers from exercising their constitutional powers • *Reversal:* preventing victors from taking office, or elected officers from concluding their constitutional terms

Source: (Schedler, 2002)

Schedler focuses on the election process because "elections have been an instrument of authoritarian control as well as a means of democratic governance". Autocratic governments

organize periodic elections "to obtain at least a semblance of democratic legitimacy, hoping to satisfy external as well as internal actors" (Schedler, 2002).

A final important contribution is *Authoritarianism Goes Global – A Challenge to Democracy*, a research program backed by NED. It covers several "arenas of soft-power competition" used by authoritarian governments like China, Russia, Saudi Arabia, Iran and Venezuela: influence on international norms, election observation, civil society, international media, and the internet. With the first, authoritarians are "reshaping international bodies founded to promote HR and democracy into forums more favorable to regimes that have scant regard for either" (Diamond, Plattner, & Walker, 2016). Through this, they challenge the universality of democracy in favor of "state security, civilization diversity, and traditional values", and reshape the international norms that stigmatize authoritarian rule. The second intends to "rewrite electoral narratives" and undermine citizen election-monitoring efforts, through "denial of access to information, cyberattacks, abuse of legal powers, electoral fraud, and manipulation of results". The suppression of civil society includes forbidding foreign financing of independent association and, eventually, opposition. Regarding media manipulation and propaganda, it focuses on international broadcasting efforts (such as RT or CCTV) but also addresses the spread of language institutes (e.g., Confucius Institutes). The chapter about interference in the cyberspace pinpoints "defensive strategies that seek to restrict access to information […] legal regulations intended to constrain the private sector […] and offensive techniques, such as surveillance and targeted cyberattacks". *Surveillance capitalism* research, particularly in China, is gaining momentum in the academia (financially backed by NED): "Beijing's experience using digital tools for domestic censorship and surveillance has made it the supplier of choice for illiberal regimes looking to deploy their own surveillance systems" (Polyakova & Meserole, 2019).

Regarding point 5., Vanderhill believed (in 2013) that China does not promote autocracy:

> "support nondemocratic governments to avoid international pressure to democratize, but there is no conclusive evidence that the Chinese government seeks to develop

> authoritarian regimes. In general, the Chinese government has not tried to influence the internal politics of other countries, has not advocated for one political faction, and has not attempted to affect regime type. Instead, China has been seeking to secure access to economic resources, especially energy sources and minerals. China may be enabling authoritarianism, but it is not promoting authoritarianism" (Vanderhill, 2013).

Burnell also argued that China aspires to become a great power, a *pole* in a multipolar world order, but "that is not the same as having a global ambition to substitute less democratic for more democratic rule" (Burnell, 2010). A recent contribution based on the USA and Australia, argues that China's foreign interventionism is different from Russia's because it aims to supplant the existing regime, instead of simply undermining it:

> "The two countries have very different objectives, rationales, and methods. For the Russian Federation, which has emerged as the West's chief spoiler, the goal has been to exacerbate existing social divisions in liberal democracies, to undermine public trust in key institutions, and to boost narratives around a host of statist themes: anti-immigration movements, the *alt-right* and trade protectionism […] China, on the other hand, has pursued an arguably more sophisticated approach given that it seeks gradually to supplant the Western order rather than simply undermine it. Its efforts therefore have been geared primarily around obtaining longer-term leverage through multiple channels of influence among elites" (Clarke, Hunt, & Sussex, 2020).

China threatens the West not only militarily or economically but also through *values* by doing business with "the good, the bad and the ugly – as long as they pay" (Harper, 2010). China fills in for the West where the political regime, for being autocratic, is *discriminated*. For them, Beijing's *market authoritarian model* is an alternative to liberal capitalism. No state has the economic clout to fully mimic China, but China engages economically without caveats. Linking to COFDI in Portugal, did the void left by the West push Lisbon to Beijing's arms? And when the USA asks Portugal to pick sides, would the electorate accept a response different than asking where were the Americans when Portugal was approaching financial collapse? According to a recent TV documentary, the French PM said to the Portuguese PM: "If someone told me that I would be one day defending the rights of the European employees against a Portuguese

Socialist, I would not have believed it", to what the Portuguese PM replied that "when Portugal was at the height of the financial crisis it was China that invested in Portugal" (ARTE, 2018). Filling the FDI void aiming at strategic engagement without aspiring to use that economic power as (*quid pro quo*) political leverage fits in the #3 play and potentially in the #4 play, but not in the #5 play of our framework.

NED has recently coined the term *sharp power* in relation to today's China and Russia:

> "Authoritarian influence efforts are *sharp* in the sense that they pierce, penetrate, or perforate the political and information environments in the targeted countries […] not necessarily seeking to *win hearts and minds*, the common frame of reference for soft power efforts, but they are surely seeking to manipulate their target audiences by distorting the information that reaches them." (NED, 2017).

Operationally, "it involves efforts at censorship, or the use of manipulation to sap the integrity of independent institutions. Sharp power has the effect of limiting free expression and distorting the political environment". Chapter 5 delves further into the practices of political warfare and their relationship with economic statecraft.

Applying these learnings to the topic of the thesis the key takeaways are the following:

- There is no such thing as a chemically pure democracy. Portugal should not be naïve to see itself as such. There are accounts of shady party financing[2], foreign media influence[3], electoral process disputes[4], biased judiciary[5] and political spying[6]; Portugal must remain on the watch, and it is not wise to be condescending about this theme.
- The verdict about Chinese influence in Portugal depends on the definition used. In a strict sense, it is very hard to find evidence of Chinese actions to acquire political interference capabilities to impact the political regime. If the definition is broad, only

2 See Contos Proíbidos, Memórias de um PS desconhecido (Mateus, 1996)
3 Global Media's shareholding structure includes Chinese (KNJ) and Angolan (via José Pedro Soeiro) interests
4 Multiple accounts of parties driving voters to vote (Antunes, Porfírio, Dinis, & Carrapatoso, 2018)
5 Judge Rangel cheat his own corruptors (Gustavo & Franco, 2019)
6 An interviewee shared that the Intelligence alerted him for his phone being tapped during a campaign when in opposition

requiring evidence that China is interested in having goodwill in Portugal to have the country's interests increasingly aligned with theirs, then the case is easy to make.

- The American record of interventionism stained its public image in Europe and undermines the American moral superiority regarding foreign political interference. This is also the case in Portugal, where the PM during the Iraq intervention supported the Anglo-American action, unlike its EU peers, the UN and its electorate. Portugal's long-lasting trust relationship with China started before the foundation of the USA, and having an ambassador requesting Portugal to choose sides was frowned upon.
- Considering where Portugal stands regarding the democracy level, it requires attention to actions targeting the loosening of horizontal accountability and manipulation of elections. Close checks on media ownership and party financing would be a good place to start (which is not the scope of this thesis). But it seems very stretched to presume that China is promoting the rise of local authoritarian elites. Who would they be?
- China is a peculiar case and to assess the workings of the hypothetical Chinese interference and influence abroad we need to dive deeper into what it has done in other countries (see Chapter 5).

3. Understanding China and its relations with the EU

3.a. Primer on China

Attempting to describe China in 45 pages, this section cannot avoid being a gross simplification of an extremely complex topic for which there is extensive literature about every single nuance. It is organized in four subsections, which build upon each other: the values, the political model, the political economy, and the foreign policy. The main arguments are that:

- China is governed by the CCP in an authoritarian manner, increasingly so, and opaque and volatile domestic political disputes drive much of its economic and foreign policy;
- The Chinese economy, which still grows very fast for global standards, is moderating its speed and is increasingly controlled by the party (both the public and private sectors);
- Its two main drivers of economic growth are (1) the search for new markets where the Chinese (state-controlled) companies can put their experience, workforce and capital to work, and (2) the acquisition of technology (externally bought or internally developed) to move China to the forefront of the sectors deemed central in the foreseeable future;
- The Chinese foreign policy is increasingly marked by an international affirmation which puts together global economic expansion and regional comprehensive power projection and plays an increasingly important role as a legitimating factor of the ruling by the CCP.

3.a.i. The Chinese Identity and Values System

This subsection introduces the idiosyncrasies of China. In doing so, it uses two interrelate concepts: *identity* and *values*.

According to Erikson's theory of identity, which is not only individual but also collective and social, *identity* is "the difference, character and sense of belonging found in interpersonal interactions and interactions between groups" (Erikson, 1994). It arises from the self-views that emerge from the reflexive activity of self-categorization or identification in terms of membership in particular groups or roles (Liu & Turner, 2018). The modern nation-state has two defining features: the nation-state system and the national identity of the inhabitants in the territory of the state (Zheng, 2004). Therefore, national identity refers to the identity of the citizens of a country with their country's tradition, moral values, ideals, beliefs, national sovereignty, and so on (Liu & Turner, 2018). The academia is already beyond the simplistic view of modern economic theory, which was centered on rational individuals who want to maximize their utility (their material well-being), and on politics as an extension of that maximization behavior. As Fukuyama explains "no one contests that human beings are capable of rational behavior, or that they are self-interested individuals who seek greater wealth and resources. But human psychology is much more complex than the rather simpleminded economic model suggests" (Fukuyama, 2018). Contemporary liberal democracies and the misleading simplification of the concept of the *End of History* ignore the unsolved problem of the "thymos" – Plato's "part of the soul that craves recognition and dignity". As we will see in the Chinese case, like individuals, entire countries can feel deeply disrespected, leading to aggressive nationalism and affirmation needs (Fukuyama, 2018).

Westerners have long "behaved as if theirs was the only civilization in the world. Until very recently, *history* automatically meant western history, *literature* meant western literature, *philosophy* meant western philosophy, and so on" (Toynbee, 1973). This is self-evident for

anyone educated in the West, and it does not take a renowned historian to legitimate such claim. But perhaps it takes Toynbee to stress that "as the world shrinks and all nations become involved with one another, our ignorance of the great and ancient civilizations of China and Japan begins to seem as benighted as the medieval astronomers ignorance of the solar system" (Toynbee, 1973). The gap was aggravated by the historical self-confinement on China's side:

> "Their exclusion of foreigners and confinement to their own country has, by depriving them of call opportunities of making comparisons, sadly circumscribed their ideas; they are thus totally unable to free themselves from dominion of association, and judge everything by rules of purely Chinese convention" (Meadows, 1847).

Starting to understand China requires acknowledging that it comes from a whole different system of thought and failing to do so probably explains why so many westerners systematically misjudge where China is going. China always saw itself as the center of the world. China in Mandarin is *Zhongguo*, i.e., *middle kingdom*. This is a sort of exceptionalism, and like the American exceptionalism it presumes that China is exceptionally better. But contrary to the American exceptionalism, China does not evangelize:

> "American exceptionalism is missionary. It holds that the USA has an obligation to spread its values to every part of the world. China's exceptionalism is cultural. China does not proselytize; it does not claim that its contemporary institutions are relevant outside China. But it is the heir of the Middle Kingdom tradition, which formally graded all other states as various levels of tributaries based on their approximation to Chinese cultural and political forms" (Kissinger, 2011).

China genuinely cares much less for distant countries. The historical rationale is that the misfortune of being placed away from China makes it harder for distant countries to enjoy the greatness of its culture. In the early XV century, Admiral Zheng He took his "ships to destinations as far as Java, India, the Horn of Africa and the Strait of Hormuz […] China's fleet possessed what would have seemed an unbridgeable technological advantage: in the size, sophistication, and number of its vessels, it dwarfed the Spanish Armada" (Kissinger, 2011). But China had no colonial intentions and stopped these expeditions: "For China's classical

sages, the world could never be conquered; wise rulers could hope only to harmonize with its trends. There was no New World to populate, no redemption awaiting mankind on distant shores. The promised land was China, and the Chinese were already there" (Kissinger, 2011).

The flip side is that China is profoundly offended by interferences in its own matters and is deeply marked by the humiliations associated with foreign dominance, namely the opium wars and the humiliation which lasted over one century. In the XIX century, when the European powers secured a technological advantage, namely on naval and military capabilities, they started forcing trade on China. Not all European products were a commercial success, but among them there were the opioids and their consumption was rampant. Chinese leaders did not appreciate the implications of opium addiction and "decided to crack down and eradicate the trade altogether". But the "British India was the center of much of the world's opium poppy growth, and British and American merchants, working in concert with Chinese smugglers, did a brisk business". After a sequence of diplomatic quarrels, the British Navy defeated China and imposed its terms in the Nanjing treaty (1842). France and the USA followed in 1843-44. Later, the Japanese imperialism also took a dent on China's territory, first in the Korean Peninsula, then Taiwan and in the mainland. The ability of the emperor to maintain territorial sovereignty eroded gradually and after a sequence of upheavals, Sun Yat-Sen proclaimed the Republic of China in 1912, with capital in Nanjing. Yat-Sen handed over the presidency to Yuan Shikai who failed in reuniting the country. Multiple provinces were controlled by feudal lords and foreigners controlled 48 ports in the early XX century. Despite participating on the victorious side of World War I, China saw its territorial claims rejected and the humiliation culminated in the constitution of a Japanese protectorate in its Manchurian province in 1932 (Rato, 2020). China would only recover under Mao, "by the reunification of the country under an assertively nationalist form of communism" (Kissinger, 2011).

China's identity includes the concomitant influence of three ancient schools of thought:

> "the Confucians, intensely conservative, believed that man fulfilled himself by playing his allotted role in a rigid order of authority. The Taoists were infinitely more imaginative and speculated deeply over the whole range of philosophical questions. The Legalists shared the authoritarianism of the Confucians, and the belief of the Taoists in the possibility of a social order which would function without deliberate intervention. But since they thought human nature to be basically bad, and rooted in self-interest, they believed that such a society could only be brought into being by the imposition of rigid and severe laws and punishments." (Toynbee, 1973).

By the Han dynasty (220 AD), the three schools had already converged into an expanded version of Confucianism, "which was a highly syncretic system, incorporating Taostic cosmological concepts on the one hand and Legalist political ideas on the other" (Toynbee, 1973). This is important because, for centuries, China was managed by a state bureaucracy whose selection was based on examination of the knowledge of the great classics, and this dichotomy of authority vs. chaos became deeply rooted.

Since the founding of the People's Republic of China (PRC) in 1949, Chinese leaders have emphasized nationalism, even more than communism: "Mao and the CCP, from the very inception of the PRC, have stake their claim to rule less on communist than on nationalist ideology" (Shambaugh, 2020). Off course Maoism was a form of Communism-Leninism, and even beyond Mao, the discourse kept a lot of communist rhetoric. But China has gradually "untied itself, in fact, from Marxism/Maoism while instrumentalizing capitalism" (Cunha, 2012). One way or the other, most Chinese are aware of the dire consequences of Maoism, which killed more than 50 million from hunger, leaving good memories.

There are 55 minority ethnicities in China, plus the dominant Han which concentrates 92 percent of the population. Freeman identifies eight distinctive features of the Chinese culture:

- "the use of ideograms rather than an alphabet or syllabary to write;
- a preference for hierarchical, meritocratic systems of governance;
- esteem for the educated who compete to man the state and deprecation of those in other walks of life;
- an obsession with "face" (prestige, dignity, status, and influence derived from the

esteem of those one respects);

- reverence for age and ancestry;
- an elite bias toward agnosticism rather than religiosity;
- an emphasis on communal propriety rather than law to maintain order, resolve disputes, and preserve social tranquility; and
- culinary traditions based on food sized for extremely fuel-efficient cooking and consumption with chopsticks" (Freeman, 2020).

We move now from the Chinese identity to the discussion of Chinese values. According to the Cambridge Dictionary, values are "the principles that help you to decide what is right and wrong, and how to act in various situations". Some believe that the "traditional cultural values that influence the psyche of the Chinese people are harmony, benevolence, righteousness, courtesy, wisdom, honesty, loyalty, and filial piety" (Lihua, 2013). *Harmony*, which is the most important value in the system means "proper and balanced coordination between things and encompasses rationale, propriety, and compatibility". *Benevolence*, central to Confucianism, "extends from the importance of familial ties and blood connections". *Righteousness* refers to justice and correctness, and *courtesy* stresses modesty and prudence. *Wisdom* demands "that one distinguish right from wrong, place capable people in suitable positions, know oneself, and be resourceful" (Lihua, 2013). *Honesty* refers to trustworthiness, integrity, and credibility, while *loyalty* is about service to the motherland. *Filial piety* demands respecting and nurturing for elders and children.

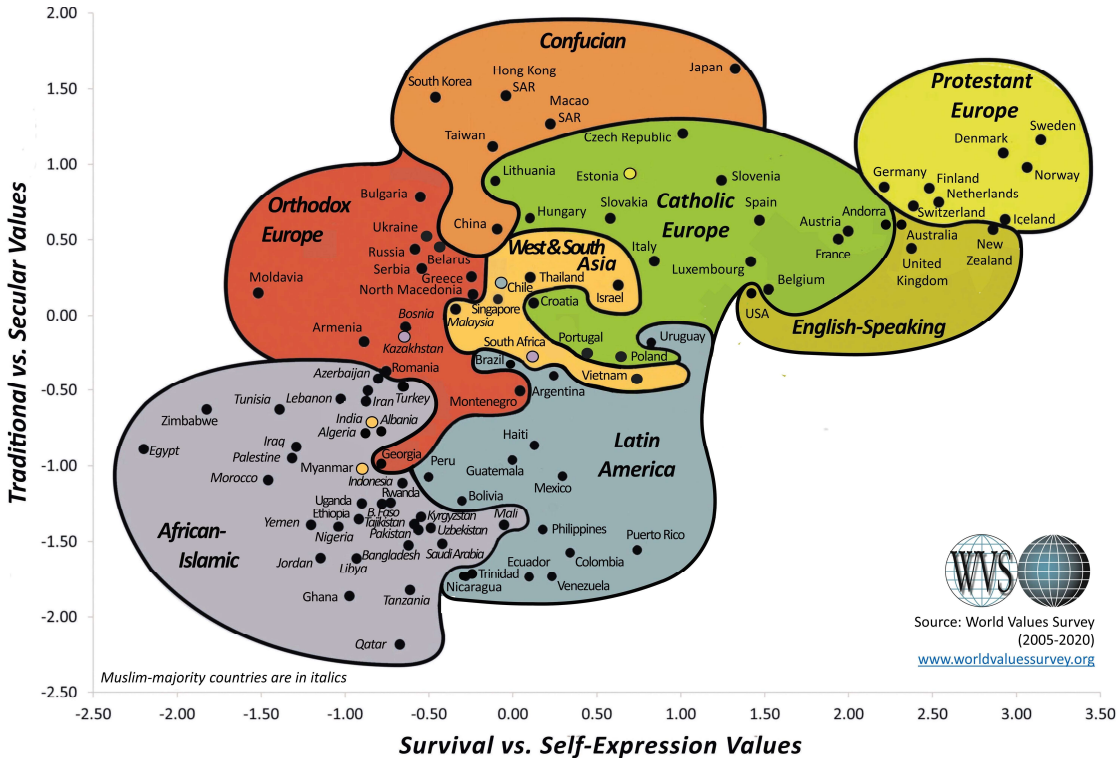
Xi Jinping himself, in the 18th Party Congress (2012), synthesized the 12 core socialist values: prosperity, democracy, civility, harmony, freedom, equality, justice, the rule of law, patriotism, dedication, integrity, and friendship. In 2013, it was issued to the party cadres the *document no.9* containing key points of attack, which were Western values and concepts that should be banned from Chinese classrooms (Brown, 2017): constitutional democracy, universal HR, media independence, judicial independence, civil society, pro-market neo-liberalism and

nihilist criticism to past errors of the party (ChinaFile, 2013). It is important to clarify that Western theories of democracy saw

> "democracy as a system of elections allowing citizens to choose and change their rulers while guaranteeing individual freedom. From the Chinese populist perspective *democracy* meant serving the people, benefiting and helping the people, not the people's choosing and perhaps changing their rulers" (Garver, 2016).

Even if the West is not homogenous, it is interesting to look at some comparisons between the Chinese and the Western values. The World Values Survey is one of the most authoritative sources on this topic (Figure 21).

Figure 21. The Inglehart-Welzel World cultural map (2020)



Source: (WVS, 2020)

Their 2020 Inglehart-Welzel World Cultural map displays 79 countries in a matrix distinguishing *traditional* from *secular* values, and *survival* from *self-expression* values. *Traditional* "emphasize the importance of religion, parent-child ties, deference to authority and traditional family values […] and have high levels of national pride and a nationalistic outlook"; *Secular* or rational values "have the opposite preferences to the traditional values"; *Survival*

values emphasize "economic and physical security. It is linked with a relatively ethnocentric outlook and low levels of trust and tolerance"; Differently, "*Self-expression* values give high priority to environmental protection, growing tolerance of foreigners, gays and lesbians and gender equality, and rising demands for participation in decision-making in economic and political life" (WVS, 2020). According to this framework, China is distant from Northern Europe but closer to Portugal, Greece, Hungary and Lithuania.

Daniel Bell analyses and contrasts three main differences between Chinese and Western values: China's political meritocracy vs. Western liberal democracy, China's hierarchy vs. Western equality, and China's harmony vs. Western freedom (Bell, 2017).

Roland identified eight key differences between Western vs. Chinese world views:

- "democracy vs. development leading to stability/peace;
- universal values vs. values free;
- superiority of liberal democracy vs. no system universally better;
- internal political diversity & external uniformity vs. internal political uniformity & external diversity;
- individual vs. state;
- missionary & militaristic vs. benevolent & peaceful;
- anarchic order vs. hierarchical (sinocentric) order;
- rules based governance vs. rule of virtue" (Rolland, 2017).

Xuetong suggests that China and the West should merge their values systems into a superior version that could guide the development of international norms. This would be possible by

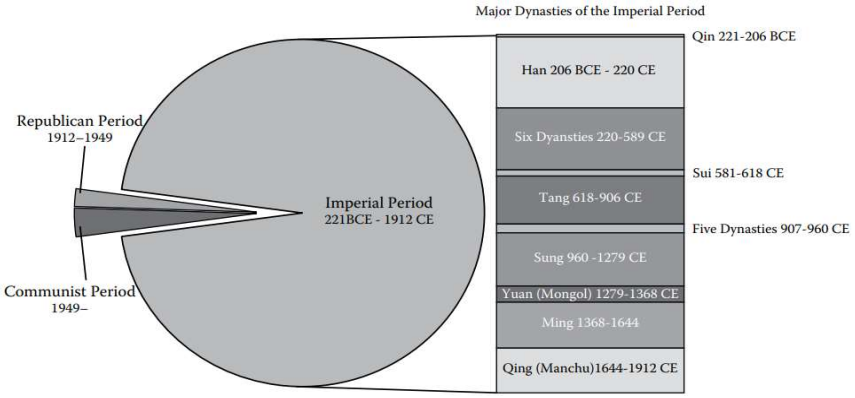
> "combining some Chinese traditional values with selected liberalist values, such as benevolence, righteousness and rites with equality, democracy and freedom respectively. The combination can produce a set of modern values of wangdao (human authority), such as fairness, justice and civility" (Xuetong, 2018).

Bridging the gap may be too much to ask but acknowledging it is the place to start.

3.a.ii. The Political system and the CCP

This subsection briefly describes the political system after Mao, which is but a tiny fraction of China's time horizon (Figure 22).

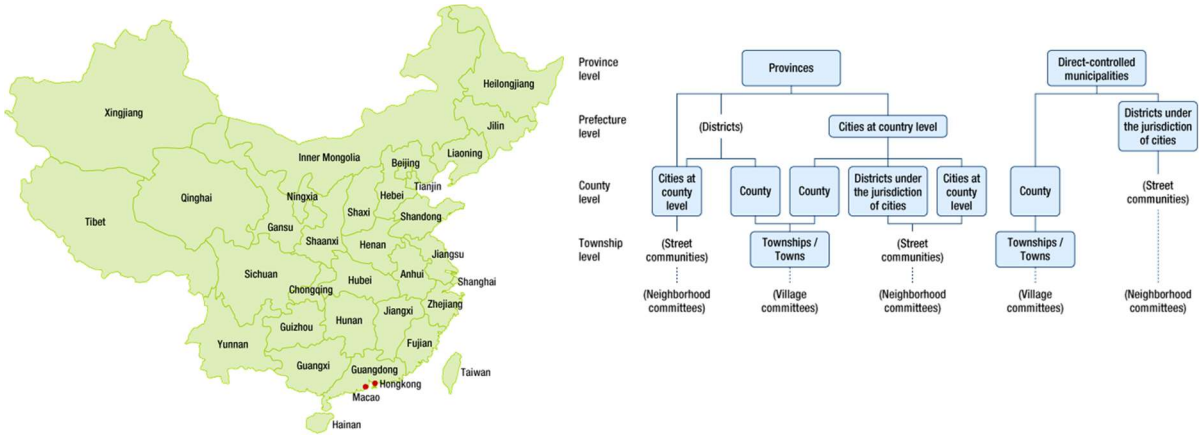
Figure 22. Chinese history from Imperial Times to the present



Source: (Joseph, 2014)

China is a unitary state, which controls 22 provinces, 4 cities with province status (Beijing, Shanghai, Tianjin, and Chongqing), 5 autonomous regions, 2 special administrative regions (HK and Macau) and Taiwan. China's political system is a bureaucratic-authoritarian one-party state, in principle highly centralized but in practice substantially decentralized (Kroeber, 2016). Villages are organized under Townships, which are controlled by the Counties that are managed by the Municipalities of each Province (Figure 23).

Figure 23. Chinese provinces and administrative map



Source: (Japan, 2017)

Article 1 of the Chinese Constitution says that "a socialist state under the people's democratic dictatorship (is) led by the working class and based on the alliance of workers and peasants". It also says that the CCP and the state are organized separately. But in practice, "it is the party that is ultimately in charge of the state, and the leader of the CCP is the most powerful individual in the country" (Joseph, 2014). There are CCP cells in all political institutions, and the CCP representatives rank higher than their horizontal counterparts in the executive (e.g., the Party Secretary in a province ranks above the Governor). Likewise, large SOE have party members as CEO or Chairmen, many of them sitting in the Central Committee (CC). Because of the difference between the word of the Constitution and the political reality, the Constitution has been nicknamed "sleeping beauty" (Brown, 2018).

To explain the political system, it is necessary to review the political institutions and their leaders. First, we introduce the key individuals who occupied the top positions since the 1950s (Figure 24), then explain the institutions and then back to the individuals and power disputes.

Figure 24. Top Chinese leaders and their roles since 1950



Source: By the author

The most important column is the *paramount leader,* which is not a formal role. The CCP sees its history since 1949 in a sequence of five generations (each with its paramount leader):

> "Mao Zedong is portrayed as the core of the first generation of PRC leaders, Deng Xiaoping as the core of the second, and Jiang Zemin as the core of the third. Although

> he was not explicitly designated as its core, Hu Jintao was the head of the fourth generation of CCP leaders, and the current general secretary, Xi Jinping, fills that role for the fifth generation" (Li C. , 2014)

The General Secretary of the CCP and the head of the Chinese Military Commission (CMC) are the top official roles. The paramount leaders tend to occupy both (plus the Presidency), with exceptions - Deng Xiaoping was not General Secretary of the CCP, and Ziang Zemin resisted for 2 years before handing over the CMC to Hu Jintao.

The political landscape is solid but not static:

> "The CCP has made it clear that it is not willing to give up its monopoly on political power to experiment with multi-party democracy, nor do Party leaders appear interested in moving toward a Western-style system based on a separation of power […] but this does not mean that the CCP is a stagnant institution that has been completely resistant to political change. On the contrary, the CCP has experienced a number of profound transformations in terms of the recruitment of party elites, institutional reforms, and ideological changes" (Joseph, 2014).

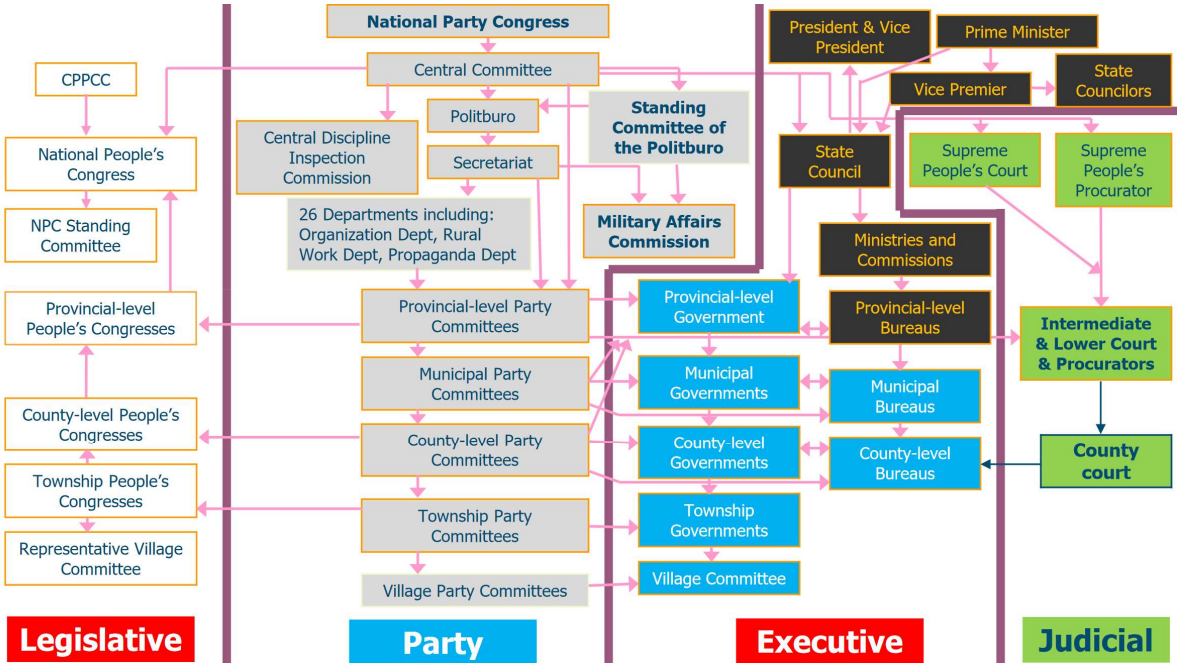
Some scholars argue that political experimentation is the most important attribute of the XXI century and China excels at that: China's political structure can be considered to have three levels, the top level, the province level and the local level; Because China is so big, it benefits from a combination of experimentation and stability, by allowing significant political experimentation at the local level, some experimentation at the province level, and full stability in the top level (Li E. , 2013).

Figure 25 presents the political structure in the early 2010s. It overlays the structures of the party: the legislative, the executive and the judicial, showing that the CCP controls everything. In the opening of the 2017 Party Congress, Xi stressed that "Government, military, society and schools, north, south, east and west – the Party is the leader of all" (Buckley & Wu, 2017).

Theoretically, the National Party Congress elects the CC, which elects the CCP's most powerful organizations: the Politburo with 25 members, the Standing Committee of the Politburo (PBSC) with 7 members, the CMC with 11 members, and the General Secretary. "In practice, however,

the process is top-down rather than bottom-up: the leading organizations of the party closely guide the selection of members of the CC, and then present to the CC for its "approval" a slate of candidates for the incoming PBSC" (Li C. , 2014).

Figure 25. China's political structure

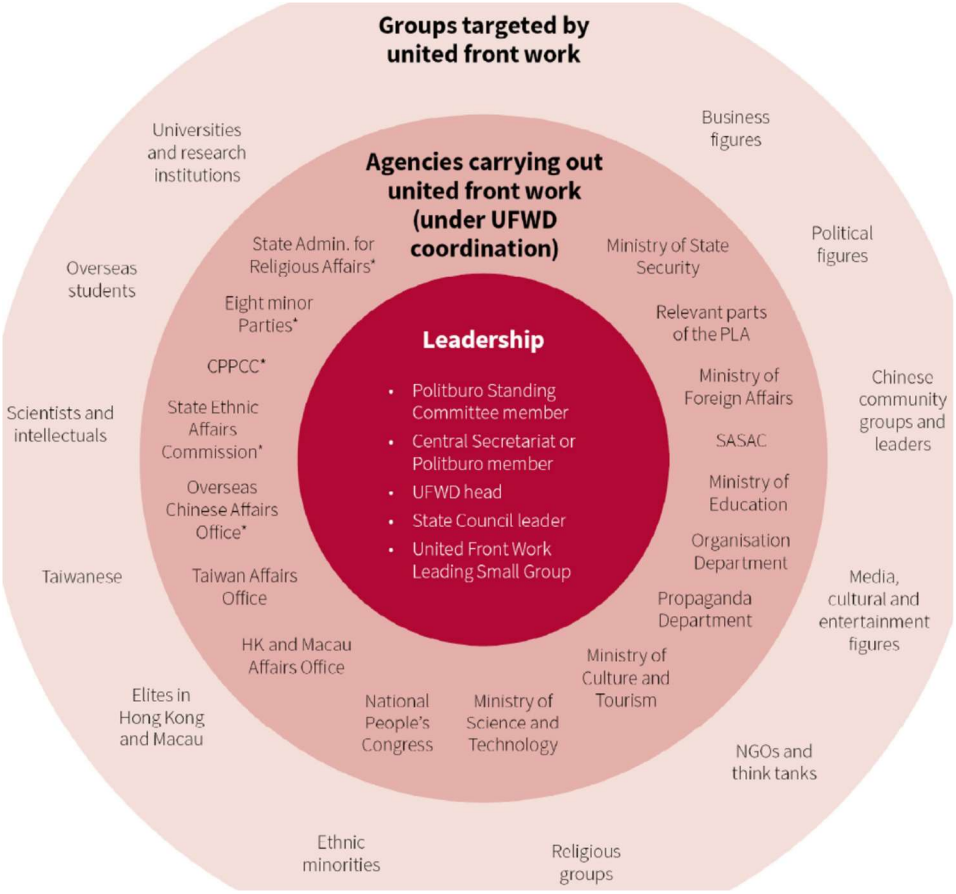


Source: (Zweig, 2014)

The most powerful men in China seat in the PSB (Cunha, 2012), and the head of the Secretariat is an heir-apparent to the Secretary General (e.g., Xi headed the Secretariat under Hu). The CC "acts as a kind of enlarged board of directors for the party in China. With about 370 full- and part-time members, the CC includes ministers, senior regulatory officials in Beijing, leaders of provincial governments and large cities, and a large bloc from the military" (McGregor, 2012). The Politburo controls the key systems, starting from the Party Affairs (party life) and Organizational Affairs (the nomenklatura). The Central Organizational Department (COD) appoints the top 4000 positions in China's political battleground: "In the absence of elections or any overtly competition for government posts, the behind-the-scenes battles to secure appointments are the very stuff of politics in China. As the clearing house for these disputes, the COD has become the institutional hub of the entire political regime" (McGregor, 2012).

The Propaganda and Education Department controls the flows of information and the national narrative, whereas the Political and Legal Affairs Department is responsible for courts, police, and the internal monopoly of the usage of force. Finance and economics are typically led by the Premier, but Xi currently leads this folder too. The United Front Work Department (UFWD) is responsible to win over or neutralizing potential CCP opponents domestically and abroad. Xi's father led this branch, and with Xi it grew in relevance (Figure 26).

Figure 26. The United Front system



Source: (Joske, 2020)

This is an important agency in our context because the UFWD is allegedly China's interference arm overseas: "the Front attempts to promote the pro-China proxy leaders in the democratic and parliamentary systems of foreign nations" (Shukla, 2021). President Xi referred to it as a *magic weapon* for the rejuvenation of the Chinese nation. In 2020, an Australian report exposed UFWD's practices and presented a map of the countries where there have been identified companies with links to the UFWD – Portugal is on the list (Joske, 2020).

The People's Liberation Army (PLA), which is the armed branch of the CCP, is controlled via the CMC. It is led by the Secretary General of the CCP but there are never military officers in the PBSC. Likewise, the Political and Legal Affairs is led by a Politburo member with no seat at the PBSC (Zweig, 2014). Currently, the CMC has 11 members and is chaired by Xi. The CCP also controls the military via its budget and the political commissars present in every unit. The Central Commission for Discipline and Inspection (CCDI), composed of 130 members, does the anti-corruption investigation and prosecution, and focuses on "cases involving CCP officials. Its most serious sanction is to purge senior level officials and expel them from the CCP; in cases where it is determined that a crime may have been committed, the matter is handed over to the state judicial system" (Li C. , 2014).

The Politburo "sets the general policy direction for the economy and diplomacy […] and [its members] have a final responsibility for deciding […] but they do not manage portfolios day-to-day in the way that ministers in a cabinet system do" (McGregor, 2012). Under Xi, the informal Leading Small Groups have gained control over all executive branches and Xi presides most of them. They are better understood as hands-on interagency groups.

The Secretariat (7) members meet daily and handle the Party's routine business and administrative matters. The Politburo meets monthly and the PBSC meets weekly.

Notwithstanding "the party's leading decision-making role, many important policy discussions, as well as most activities relating to policy implementation, take place in or through government institutions, not CCP organizations" (Li C. , 2014). On the executive, the State Council looks like a Western cabinet and "is headed by the premier, and its Executive Committee consists of the premier; four vice premiers; and five state councilors, who are senior government leaders with broad responsibilities (one of the state councilors also concurrently serves as secretary-general of the State Council)". It is composed of "more than two dozen members, including

ministers or commissioners who head functional departments such as the MFA […] the central bank governor and auditor-general" (Li C. , 2014).

The China's People's Political Consultative Conference (CPPCC), which is composed of notable individuals (not necessarily from the CCP), is an important organ meant to engage in political consultation with the CCP and provide non-binding recommendations.

Each of the paramount leaders is associated with one synthesis of thought governing the CCP. Mao's thought is a Chinese version of the Marxism–Leninism for which he used an historical expression – *seeking truth from facts* – from the Book of Han: "In the key elements of Mao Zedong Thought are Marxist revolution, the importance of the peasants, mass mobilization and voluntarism, continuous revolution, proletarian revolution, self-criticism, class struggle, and the primacy of Mao Zedong Thought" (Dabphet, 2018). The Mao era was disastrous: "overwhelming scholarly opinion is that it was, as a whole, a disaster for China, economically, politically, culturally, environmentally, and in other ways" (Joseph, 2014). Despite that, Deng endured significant challenges to take over the power from Mao's designated successor Hua Guofeng and the radical *Gang of Four*. His was an informal but effective power. In control since 1978, "he was never president, nor Party Secretary, although he maintained leadership of the military until 1989" (Brown, 2018). It is still debated today if Deng was a protégé of Mao or Zhou Enlai, Mao's premier (Cunha, 2012).

After Mao, there have been four syntheses of Socialism with Chinese characteristics. For Deng,

> "the fundamental task that faced the nation was economic development, which required accelerated technological innovation, increased productivity, product quality enhancement, and managerial competence. In making his case, Deng placed primary emphasis on the development of the forces of production" (Chang, 1996).

Like his successors, Deng pursued the reform and opening without entirely refusing the validity of Mao's thought. He was very *neo-bismarckian* in avoiding armed conflicts (Cunha, 2012).

Deng had two reformists as right-hands, and they were both Secretary Generals of the CCP. First Hu Yaobang, and later Zhao Ziyang. While Deng was the father of the economic opening, Hu and Zhao were also sympathetic to the idea of gradual political opening. It was Hu's death that sparked the demonstrations leading to the Tiananmen massacre of 1989. Zhao, who was premier in 1980-88 and the Secretary General of CCP in 1988-89 was also very reformist even if he did not embrace multi-party dynamics. He defended "separating Party and government; decentralizing powers; reforming the personnel system for cadres and the government structure; doing better at consulting the public; and strengthening the socialist legal system" (Brown, 2020). He fostered the emergence of private trading companies on the coast, which were critical to the export-led economic success of the subsequent decades. He was arrested and imprisoned for life just before the crackdown on Tiananmen for empathizing with the demonstrators. He was able to record his memories which were published in the West after his death in 2005, leaving no doubt about his reformist vision for China. Because Deng still controlled the CMC, it was possible for Deng and Li Peng to oust Zhao and bring "two crack regiments from outside Beijing whose loyalty was undisputed" and crackdown on the demonstrators (Brown, 2020). Since then, it was made clear that the interlocking between the party and the state was definitive (Cunha, 2012) and there was no room for Western democratic concepts anytime soon.

Ziang Zemin, who succeeded Zhao, has rationalized his political developments as the *three represents*, which included: (1) the importance of the "advanced productive forces", namely the role of science and technology as primary productive forces for economic modernization; (2) the "orientation of China's advanced culture"; and (3) the "fundamental interests of the overwhelming majority of the people in China". He calls for a symbiosis between China's traditional values and the concern for the interests of the population in the progress of the reform. Central to his program was the SOE reform known as *grasping the large, letting go of the small,* which had the benefits of improving the solvability of the public corporate sector,

but as a result "the employment in the SOE sector dropped by almost half from 70 million in 1997 to around 37 million in 2005" (Economy, 2018). There has been a good deal of political testing in the latest years of Jiang Zemin and the first five years of Hu Jintao, organized by the influential Zeng Qinghong. Zeng was First Secretary of the Central Secretariat of the CCP, preceded by Hu Jintao and succeeded by Xi Jinping. He was a politburo member and a protégé of Ziang's who brought him from Shanghai to Beijing. Zeng's experiments included:

- "experiment with voting for multicandidate Party secretaries, while expanding nationwide multicandidate elections for local government officials;
- recruit more businesspeople and intellectuals into the Party;
- expand party consultation with non-party groups;
- increase the transparency of the Politburo proceedings;
- foster inner-party democracy;
- regular consultations between the CCP and the CPPCC;
- rebuild local party cells and committees;
- more meritocratic criteria for evaluation and promotion of cadres;
- mandatory mid-career training for all 45 million state and Party cadres;
- enforced term limits and retirement requirements;
- rotation of officials and military officers;
- loosened controls on the state and private media;
- greater scope for intellectuals and pluralism;
- allow growth of NGOs;
- introduce more foreign ideas in the higher education system" (Shambaugh, 2016).

The Chinese politicians got used to tolerating demonstrations. In 2010 alone, there were 180.000 demonstrations (Shambaugh, 2016), which helped surfacing local power abuses.

The transition from Ziang to Hu was not entirely pacific, and their antagonism persists. By 2005, the PBSC was "divided in two groups – the *managers* (Wu Bangguo, Wen Jiabao, Li Chanchuou) and the *bureaucracts* (Hu Jintao, Zheng Qinhong, Jia Qinglin, Huang Ju, wu Guanzheng, Luogan)" (Romana, 2005). Hu worried about the growing imbalances and wanted a more balanced development model. The *scientific development* is Hu's contribution, and means that "China has to change from over-reliance on a cheap labor force, funds and natural

resources to well-educated workers and improvement of science and technology, a development mode that not only values quantity and speed but also high-quality and energy-saving" (Daily, 2010). China needed to "modify excessive reliance on economic expansion, and to seek, as a national goal, a 'people-centered', 'all-round' approach" (Kuhn, 2010). In 2006, started emerging signs of growing party control, although shy of what Xi would bring. Hu respected the collective leadership and his transition "to Xi was the cleanest and clearest in PRC history: Hu left all positions by March 2013, moving completely to retirement" (Brown, 2020).

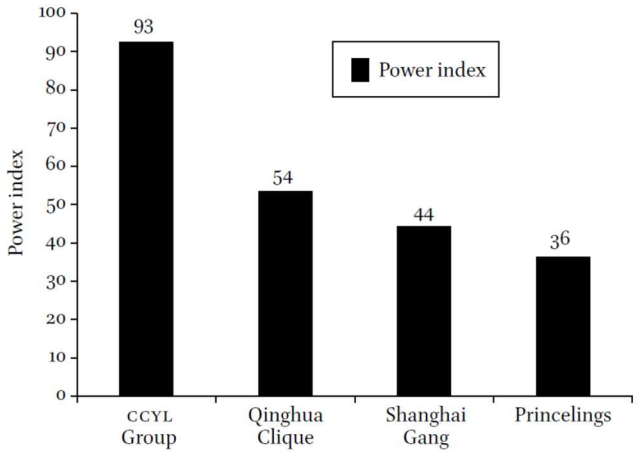
If Mao's China was about *standing up*, and from Deng to Hu China focused on *getting rich*, Xi's China is all about *becoming powerful* (Markey, 2020).

Xi's Chinese Dream is central to his leadership. It means the *great rejuvenation of the Chinese nation* and has many interpretations. Xi's interpretation is associated to the affirmation of the "Chinese nation as a strong and prosperous party-state that has a global influence (Callahan, 2013). In public speeches, Xi "also made clear to Politburo colleagues and other leaders that the country needed to proactively tell its own story. While not framed as such, this was an indirect criticism of the Hu era, where silence had been the order of the day" (Brown, 2020). Using all soft-power tools available (media, language institutes, think tanks, etc.) but also outright public diplomacy. From the beginning, Xi identified several foes, both domestic and foreign. Widespread corruption in the party and in the military, and foreign-led subversion of domestic values and territorial integrity were the main concerns (Garver, 2016). The situation called for internal cleansing and comprehensive power projection overseas. The first five years were marked by the crackdown on corruption, the China Dream and the industrial policy centered around the *Made in 2025* program and the BRI. This subsection covers the first point, whereas the others are covered later.

In the anti-corruption campaign, "many members of Jiang Zemin's factional network, and a rising number of Hu Jintao's, have been brought down – yet none of Xi's own princeling

associates have been touched" (Shambaugh, 2016). The Chinese political system, which observes throat cutting elite politics competition, has long been understood around four factions (Figure 27), even if some elements have strong networks in more than one faction.

Figure 27. Balance of power among factional groups in China (2002)



Source: (Brodsgaard, 2017)

This is a very opaque and important matter to understand the domestic politics of China. In brief, the Chinese Communist Youth League (CCYL) is the youth movement of the CCP, and this faction includes former members of the CC of the CCYL. Among its historical *First Secretaries* are former CCP General Secretaries Hu Yaobang and Hu Jintao, and current premier Li Keqiang. The Shanghai Gang "has a leader Jiang Zemin, and is based on a patron-client relationship between Jiang and his followers" (Brodsgaard, 2017). The Qinghua Clique includes those coming from the important Tsinghua University, such as Hu Jintao and Xi. Nevertheless, Xi is more associated with the princelings, which "refer to children of former high-ranking officials of the CCP" (Brodsgaard, 2017). This faction includes Bo Xilai, who was one of the most senior officials purged by Xi's campaign. Zhou Yongakang "considered one of Xi's most formidable adversaries" had the same destiny (Economy, 2018).

The military was also subject to significant cleansing and the most senior target was the former Vice-President of the CMC (General) Guo Boxiong. In 2013-18, under Wang Qisha, the CCDI has "handled 1.54 million cases, involving 1.53 million cadres. Of these, 58,000 were

transferred to the judiciary for formal trial, double that of the previous 5 years" (Brown, 2020). The military was subject to a major reform which goes well beyond the workings of the CCDI: "Xi has profoundly revamped the PLA administrative lineup, restructured its regional organization, and reshuffled officers across departments, regions and services" (Lin M. , 2016) The West tends to have a simplistic view of this theme, namely Xi Jinping using this campaign in a strictly self-serving elimination of his opposition. We will never know his inner intentions, but what is certain is that Xi made his career carrying the anti-corruption flag, which has been one of the most important, yet unattended, concerns of the population. In fact, "one frequently offered rationale for Xi's consolidation of power is that it is necessary to clean up the party and push economic reform" (Economy, 2018). Many expats in Beijing and Shanghai believe that

> "As an experienced senior leader, Xi Jinping knew well the depth of the power of some factions, namely Jiang's business fellows but also others, who control incommensurable amounts of power through the SOEs and *private looking* corporations fully financed by state banks. Jiang built such a powerful network that Hu had little room for maneuver and Xi witnessed that first-hand. Xi had two options, to let it spread further, like Hu, or to cut it all out at once. He chose the latter." Anonymized quote from an interviewee.

Since 2017, Xi upgraded the authoritarian controls in many ways: surveillance technologies (Mattis & Brazil, 2019); social credit systems to monitor, rate and shape behavior; tighter capital controls on OFDI; limitations to independent media and NGO (Economy, 2018); CCP control over private and state companies (Lardy, 2019); and the abolition of succession rules. Xi "was reconfirmed as leader of the CCP in October 2017 and then abolished term limits on his presidency in March 2018, removing any obstacles to his remaining in power in perpetuity" (McGregor, 2019). Lee Kuan Yew said that "he has iron in his soul, more than Hu Jintao, who ascended the ranks without experiencing the trials and tribulations that Xi endured" (Shambaugh, 2016). Xi is "the chairman of everything" (Brown, 2020).

Xi Jinping Thought is already incorporated in the Constitution and is composed of 14 points:

1. "Ensuring Party leadership over all work.

2. Committing to a people-centred approach.
3. Continuing to comprehensively deepen reform.
4. Adopting a new vision for development.
5. Seeing that the people run the country.
6. Ensuring every dimension of governance is law-based.
7. Upholding core socialist values.
8. Ensuring and improving living standards through development.
9. Ensuring harmony between human and nature.
10. Pursuing a holistic approach to national security.
11. Upholding absolute Party leadership over the people's forces.
12. Upholding the principle of 'one country, two systems' and promoting national reunification.
13. Promoting the building of a community with a shared future for mankind.
14. Exercising full and rigorous governance over the Party." (Noi, 2017).

Xi frequently refers to his doctrine of the *four matters of self-confidence*, which are "confident in our chosen path, confident in our guiding theories, confident in our political system, and confident in our culture" (Jin, 2020). These, in turn, sustain Xi's four comprehensives: to comprehensively (1) build a moderately prosperous society, (2) deepen reform, (3) govern the nation according to law and (4) strictly govern the party (BBC, 2015).

A Western reader may regard these synthetic enunciations as too generic, but such reasoning would be unwise. Xi's thought and its inclusion in the Constitution is an important milestone:

> "In China, an extremely complex and potentially fragmented country, this ideological consensus has been hard won, and once agreement is reached, it must be well defended. Getting agreement on a single belief system for the political elite is not the business of a day, or even a year. It takes decades, and the expenditure of much blood, sweat and tears. Having a broad consensus among the main leaders of the Communist Party and the Party state under it means that they have a common language" (Brown, 2018).

The party's antipathy toward private capital is not ideological, but actually about *real politik*: "party's distrust for the private sector was never about money nor the flagrant contradiction between individual wealth and the official Marxist and Maoist pantheons […] the real issue for the Party was the threat that the foreign and local private sector might become a political rival"

(McGregor, 2012). Most of the leaders understand that the market mechanisms play a crucial role in the economy. There is less consensus for support of an all-encompassing private sector, in part because of the belief that competition can also be achieved among SOEs. Kuhn described Xi, in 2010, as "a strong advocate of pro-market reforms, stressing economic efficiency and further market liberalization, and has a long record of promoting the private sector. He has been described as the candidate of China's entrepreneurs and growing middle class" (Kuhn, 2010).

Finally, it is important to analyze the sources of legitimacy of the CCP, and the core interests of China through his eyes. Because China is not a liberal democracy, it does not enjoy the legitimacy coming from countrywide elections. Moreover, Tiananmen showed that, at some point in time, the political establishment was effectively questioned by some constituencies. At the same time, there is evidence that the legitimacy of the CCP has increased in the subsequent decades, even if the drivers of such legitimacy are not consensual. Legitimacy is one among three elements used by autocracies to remain in power, the other two being repression and co-optation. Repression concerns "repressing threats to the regime's hold on power". Co-optation is more about identifying key supporters and potential opponents and attracting them into the regime: "Those selected for co-optation gain privileged access to political influence, economic rewards, plum jobs, and other scarce resources. In return, the regime expects support from the people who receive these benefits" (Dickson, Shen, & Yan, 2016).

Lipset argues that *legitimacy* is the capacity of the system to engender and maintain the belief that the existing political institutions are the most appropriate ones for the society (Lipset, 1960). Gilley described it as "rightful rule, where rightfulness entails meeting the shared moral standards of a political community" (Gilley, 2009). Others question such definition, because "legitimacy does not signify that power will be used to promote the good of the nation or humanity. Rather, it implies only that the populace acquiesces to the exercise of governmental

power" (Levi, Sacks, & Tyler, 2009). Legitimacy is also the aggregated sum of the perceptions of multiple individuals and about several layers and institutions:

> "we need to conceptualize legitimacy as the net sum of those 'partial legitimacies' of moral values, institutional order, and roles of authority which are generated in different spaces, as well as different administrative layers and by different personal relationships within the Chinese political system" (Schubert, 2008).

There have been multiple studies measuring the level of legitimacy based on public opinion data, which have been finding "high levels of regime legitimacy in China" and also that trust in the central state is "much higher than for the local state" (Dickson, Shen, & Yan, 2016).

First, "the CCP's claim to have been the protector of China's national sovereignty from the 1950s to the present is one of the most powerful sources of its political legitimacy". Nevertheless, even though the party still invokes the memory of the revolution, it "recognizes that this is no longer an adequate claim to political legitimacy" (Joseph, 2014). In 2004 there was a CCP resolution recognizing that the party's "governing status is not congenital, nor is it something settled once and for all" (CC, 2004). Avoiding to attempt to rank the legitimacy sources, the literature is reasonably consensual about what is the top 3, for both the Party and the population: (1) an economic performance legitimacy based on the sustained economic growth; (2) a nationalistic legitimacy associated with the affirmation of China as a powerful international actor redeemed from its century of humiliation, and the maintenance of territorial integrity; and (3) CCP's unique ability to maintain the order and avoid chaos.

Dai Bingguo, who led the Foreign Affairs Leading Group under Hu, said that "China's number one core interest is to maintain its fundamental system and state security. State Sovereignty, territorial integrity and economic development, the priorities of any state, all are subordinate to the need to keep the party in the power" (McGregor, 2012). Yang argues that the sequence is:

> "first, the stability of the state system, the government, and the political situation in China, namely the leadership of the CPC, the socialist system and the socialist road with Chinese characteristics; second, the security of China's sovereignty, territorial integrity

and national unity; and third, the basic guarantee of China's sustainable economic and social development" (Yang, 2014).

In 2009, Xuetong argued that the Party was too focused on economic growth:

> "They think that as long as the people believe they can make more money, they have the right to rule the country, no matter how much territory they might concede. This is the mainstream ideology in this country, but I think this position will lead to disaster" (McGregor, 2012).

What is also reasonably consensual is that corruption, pollution, inequality, bureaucracy, inadequate political participation, inadequate rule of law and inadequate provision of welfare are among the most important challenges to CCP's legitimacy. Addressing these concerns will be an important source of legitimacy in the foreseeable future.

The Chinese political orientation has been volatile. Shambaugh identifies five different periods since 1985-2015 and a clear trend towards harder authoritarianism with Xi Jinping (Figure 28).

Figure 28. China's political Orientation

Period	Political Orientation
1985-1989	Liberal Neo-Authoritarianism
1989-1992	Neo-Totalitarianism
1993-1997	Hard Authoritarianism
1998-2008	Soft Authoritarianism
2009-2015	Hard Authoritarianism

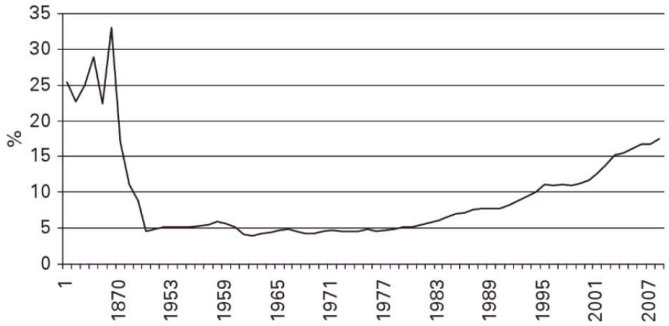
Source: (Shambaugh, 2016)

But as we have seen, China is not the West, and its legitimacy has different sources. Xi dares to speak about dreams and future, something lacking elsewhere. Could Brown be right in saying that "it would be ungenerous to want to deny the Chinese people their moment of regeneration. In the end, their aspirations and hopes are the real autocrats of modern China. Xi is merely the servant of these"? If he continues delivering, his leadership will be secured (Brown, 2018).

3.a.iii. The economic development model and the industrial policy

China represented 33 percent of world's GDP in 1820 (Figure 29). Its decline in the XIX century and its rise since 1980 are amongst the most impressive economic phenomena in history.

Figure 29. China's share in global GDP (%)



Source: (Lin J. Y., 2012), based on (Maddison, 2006)

This subsection describes China's development recipe and its current economic status. The sinological landscape is plentiful but littered with wrong predictions (Shambaugh, 2016) because western analyses systematically foresaw a *demise* which never came. Moreover, "naïve or self-serving Western observers long held the belief that a China going to market would also converge with the West's political systems" (Godement, 2016). Fukuyama's *End of History* was wrong, and Fukuyama himself reflected on how his theory fueled an American *China Strategy* privileging engagement over containment. This thesis prefers sources without a bias for the *demise* trap and the democratic transition wishful thinking. Three examples are Barry Naughton, Arthur Kroeber and Justin Yifu Lin. The first wrote the bestsellers *The Chinese Economy: Transition and Growth* and *The Chinese Economy: Adaptation and Growth*. The second is the author of the current bestseller *China's Economy: What everyone needs to know*, which is the favorite of the IMF China team itself. Lin was Chief Economist of the WB and teaches at the China Center for Economic Research at Peking University, which he founded.

A few core variables are present across virtually all economic development models: (1) the endowment of production factors: natural resources, labor and capital; (2) the industrial

structure, because "if the factors of production are allocated to industries with higher value-add, output will increase" (Lin J. Y., 2012); (3) the speed of technological progress; and (4) the institutions, which enable or limit the economy's ability to reach its full potential.

China was always populous "thus enjoyed certain advantages in invention and technological innovation", which were leveraged by a "civil service examination system, which improved resource allocation, allowed social mobility and facilitated national unity" (Lin J. Y., 2012). This was relevant until the scientific and industrial revolutions because experience drove innovation, so more farmers meant more agricultural innovation. Since the scientific revolution, it became possible to boost innovation with controlled experimentation, where creativity and mathematical skills make up for smaller scale. Modern science appeared in Europe and not China because "China had a bureaucratic system whereas Europe had a feudal aristocratic system, the latter more favorable to the cultivation of mercantilist values. With the collapse of the feudal system in Europe, capitalism and modern science emerged" (Lin J. Y., 2012). China's inability to keep up with the Western institutional progress (the fourth factor) led to a disadvantage in technological progress (the third factor), which implied a lower marginal productivity of capital and labor (first factor). China accounted for 5 percent of global GDP until it could design and implement a plan to overcome its technological backwardness.

After Mao, Deng designed a development strategy imitating the most successful development strategies with some nuances. The basis for emulation was the *East Asian development model*, which was an adaptation of the successful Western catch-up strategies of the XIX century: the *American system*, conceptualized by Hamilton and Clay, and Bismarck's *German system* by Friedrich List (Kroeber, 2020). Like its precursors, the Chinese model was based on three components: (1) "*land to the tiller* agricultural reform" which means "breaking up big estates or plantations and creating a class of rural smallholders" – because yields are higher in fragmented ownership, this creates "a significant agricultural surplus" which is more easily

captured by the state, and provides "seed capital for state-led investment in basic industry and infrastructure (Kroeber, 2020); (2) "*Export-oriented manufacturing*", because "to get rich, poor countries must undertake a process of *technological catch-up* in which they acquire technology from rich countries and use it to boost the productivity of their own workforce" - exports are the means through which low-skilled labor is converted into foreign reserves, which are then used to acquire the needed technology; and (3) "*financial repression"*, which is "a set of practices designed to control financial markets so that the state can direct capital to the sectors favored by its development strategy" (Kroeber, 2020).

The Chinese case had two differences. One geopolitical, because while Japan, South Korea and Taiwan could resist market opening in exchange for USA military presence, that option was not available in China. The other was the lack of a local aristocracy, like the Japanese Keiretsu or the Korean Shaebel. This led to Chinese peculiarities: "first, China has relied far more heavily on SOEs"; second, "the extensive use of FDI. FDI played virtually no role in the postwar development of Japan, South Korea, or Taiwan; in China, it was central" (Kroeber, 2020).

Other types of local companies played an important role in the beginning, namely the township and village enterprises (TVE): "Many were funded by local governments or received loans from local credit cooperatives, where peasants had put some of their newly gained disposable income, while others operated under contracts with urban SOEs that sought to expand outside of the state-controlled sector of the economy" (Zweig, 2014).

At first, TVE did well against SOE and "by 1994, over 50% of all products purchased in China by state-run foreign trade companies for export came from TVEs". Their success owed much to the lack of legacy, since they "were unburdened by welfare costs – workers' housing, medical benefits, subsidized meals, schooling, and retirement benefits – that saddled SOEs, so their costs were lower" (Zweig, 2014). Gradually, TVE managers tied with the power elite acquired the companies. The local governments "supported this wave of privatization because private

firms generated more profits and taxes than collectively owned ones". TVEs "that proved unable to make the transition from collective to private ownership were closed". By the 2000s, "collectively owned TVEs have largely disappeared from China" (Zweig, 2014).

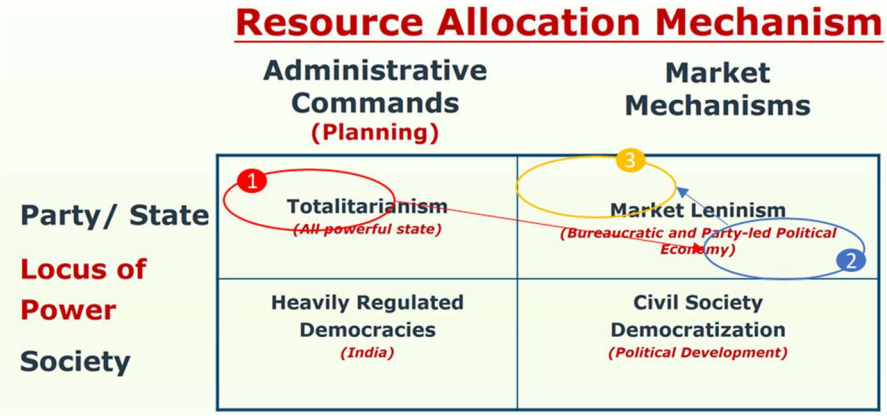
China's economic dilemma was four-fold: (1) how to mix public and private initiative, (2) how to accumulate technology and innovation the fastest, (3) how to generate liquidity while keeping a healthy banking system, and (4) how much and how to open its economy to the world.

China studied the lesson of post-communist nations and applied a gradualist approach (Deng's *crossing the river by groping the stones*), which mixed market economy with state intervention and market access with protectionism. It is not fully recognized that there was more economic liberalization until 2006 and an inverse trend of interventionism thereafter. In the early 2000s,

> "market transition was undoubtedly the overwhelming focus of Chinese policy-makers […] there is little debate about the nature and cause of this achievement: China shifted to a market economy, growth accelerated, and rapid structural and technological upgrading followed. Less widely appreciated, however, is that from about 2006, China began to make further fundamental shifts in development strategy. Direct government intervention in the economy – which had dwindled to almost nothing in the years 1998-2005— gradually began to increase" (Naughton, 2021).

China developed a subtype of market Leninism which Naughton calls *government-steered market economy*. Zweig proposes a political framework (Figure 30) plotting each system in a matrix of locus of power (party vs. society) and resource allocation (planning vs. market).

Figure 30. Political Economy of China since Mao



Source: By the author based on the matrix proposed by (Zweig, 2020)

Totalitarianism exists when a very high state power is exercised through (a) a totalistic ideology explaining the past, present and future; (b) a single party led by one man; (c) a centrally-planned economy, (d) terroristic police and (e) a communications monopoly (Zweig, 2020).

China had (1) a totalitarian system with Mao, migrated to a (2) softer market-Leninism model in the 80-90s (from Deng to Jiang Zemin), and since the mid-2000s (with Hu and Xi) it (3) gradually became more authoritarian, with higher party control over the economy and less checks and balances outside and within the CCP. Under Deng, it adhered to market mechanisms including more capital mobility and streamlining of unprofitable SOE. But

> "along with a surge in growth came a wave of entangled problems, of inflation and social unrest fueled by mass layoffs from state companies and anger at official carpet-bagging of the assets left behind. The party looked anything but in control in the extraordinary upheaval starting in the early to mid-nineties." (McGregor, 2012).

In the banking system, "45% of loans made before 2000 had gone bad. The legacy of years of poor and often corrupt management of the state-banks was now more than just a drain on the exchequer. It was a lethal threat to the entire economy" (McGregor, 2012). Zhu Rongji, Premier since 1998, implemented the SOE's strategy of *grasp the big, let go of the small*. In the early 2000s, "the restructured enterprises, many of them built from scratch, were so big, wealthy and ambitious that the problem now was not how to keep them alive, but how to keep them in line". But "the Party has retained its influence by maintaining power over all senior appointments. Through personnel, they can in turn direct corporate policy" (McGregor, 2012). In banking, the COD took control by creating a powerful "yet mostly invisible party body for monitoring financial executives". It was not formal, but "the backing of the Politburo and the direct threat to the jobs of provincial bank executives were more than enough" (McGregor, 2012).

The banking restructuring is estimated to have costed "USD 620Bn, equal to ~28% of Chinese GDP in 2005 […] the big state-banks cut the number of branches from 160,000 in 1997 to 80,000 in 2003. ICBC got rid of about 200,000 employees" (McGregor, 2012).

Some say that the model changed from *state capitalism* to *party-state capitalism* (Figure 31).

Figure 31. From state capitalism to party-state capitalism

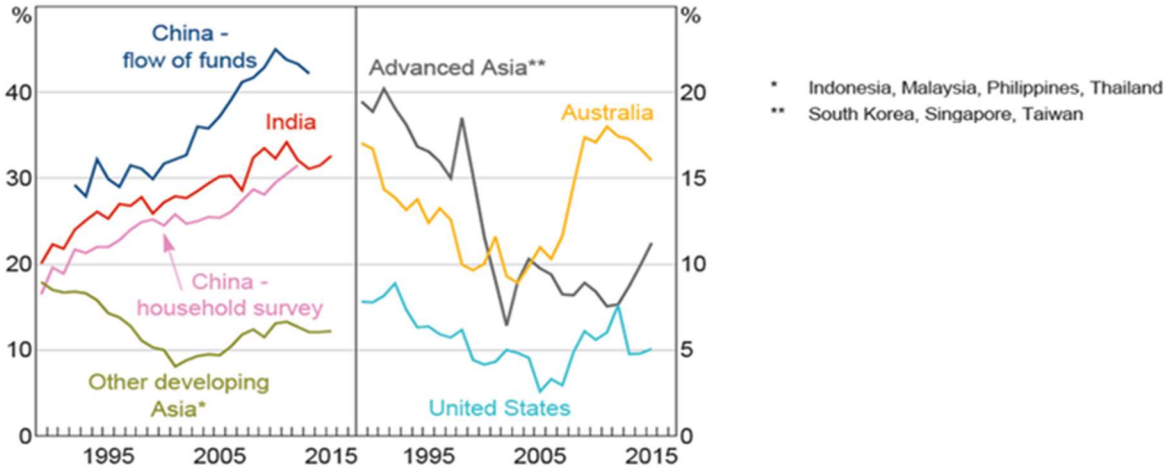
	***State capitalism** (to late 2000s)*	***Party-state capitalism** (since late 2000s)*
Core motivation	Protect core state assets to create wealth and protect interests at home and abroad	Enhanced CCP monitoring and control to ensure political survival
State ownership & financial stakes	Primarily SOEs in strategic sectors SASAC as asset manager Ambiguity in definition of non-state (*minying*) enterprises	Financialization of the state via state-owned capital investment companies, and state purchase of special management shares in media & tech companies Further blurring of ownership categories including rise of "mixed ownership"
Party branches	Primarily in SOEs and large private firms	Extension of party cells to over 2/3rds of all non-state firms Installation of "special directors," e.g., to veto media content
Industrial policy	Targeted at SOEs & mid-tier industrial sectors Preferential access to credit and subsidies	Industrial guidance funds in critical sectors use and target the private sector to implement
Moral hazard	Soft budget constraint of SOEs	Prioritization of stability begets state receivership for troubled firms New layers of agents beyond Party's disciplinary systems
Management*	Top management of SOEs appointed by CCP Top executive positions (general manager, party secretary, board chair) held by different people Latent party cells	Heightened inspections, rotations, and punishment of management via anti-corruption campaign Increased joint appointments of top executive positions (e.g., party secretary and board chair) More prominent role of party cells in corporate governance
Foreign economic policy	"Going out" investment led by SOEs	Belt & Road Initiative; increasing outbound private investment; political correctness expected by MNCs

Source: (Pearson, Rithmire, & Tsai, 2021)**,** based on (Leutert, 2018)

The party stepped up its intervention in both private and state companies, spreading ownership and financing, nomination, punishment of managers, and (since 2016) "embedding of the communist party in the corporate governance structure", increasing party cells in private companies and party secretaries moving up the structure to preside many boards of directors. Almost 50 percent of the companies have party cells, a number that reaches 92 percent among the largest 500 (Doyon, 2021). Another important signal was the new regulation on shadow-banking (2018), which was a crackdown on non-centrally controlled sources of financing.

For the first 25 years, China exploited the increase in production factors via the demographic dividend and the rural-urban migration, while enjoying very high savings rate (Figure 32) that financed massive capital formations in infrastructure and basic industries.

Figure 32. Household gross savings rate



Source: (Stratford & Cowling, 2016) based on CEIC, NBS, RBS; Thomson Reuters

Through inward FDI, it attracted capital, quality management and technology, and the economic results were impressive across multiple dimensions. There was a policy change around 2006, which was a response to the eminent slowdown of GDP, not its cause: "to be sure, the new policy package was a *response* to the slowdown, not the cause of it" (Naughton, 2021). There was never a consensual estimate of the weight of the private sector. Illustratively, in September 2005, CLSA estimated that "the private sector now contributes more than 70% of GDP and employs 75% of the workforce", while "UBS, the Swiss Bank, put out a rejoinder, saying the private sector accounts for no more than 25%" (McGregor, 2012).

China maintains its markedly socialist 5-year plans, which remain a powerful tool to communicate the CCP's priorities. While rising, China exacerbated important imbalances such as inequality (including the hukou system), environmental deterioration, corruption, political dissidence, indebtedness of SOE, high levels of non-performing loans and a worsening demographic pyramid. There is also the threat of the *middle-income trap* (coined by the WB in 2006), which predicts a slowdown if new growth drivers are not found (e.g., technology, domestic demand and new markets). China refused to follow the *Washington consensus*. It does not employ the conventional Western recipe of increased economic and political opening, but rather increased interventionism, authoritarianism, and international affirmation.

By the mid-2000s, Hu Jintao was calling for sustainable development, but the financial crisis demanded an emergency response which was materialized as a stimulus package which aggravated some imbalances. China overheated its economy and the private investment was crowded out by public investment (Lardy, 2019). In 2012, the WB issued the report *China 2030: Building a Modern, Harmonious and Creative Society* demanding less state: "if there was a coherent, lengthy statement of western-style neoliberal economic values imported lock, stock and barrel to the PRC, this was it" (Brown, 2017). But China had already made its mind: no matter the merits of such approach, in realist terms it serves the hegemon more than itself. China saw in the financial crisis an opportunity to affirm itself in the world. Wang Hui, the prominent *new left* intellectual was one of the voices calling for increased autonomy: "we should search for an autonomous development strategy and break away from the division of labor imposed by capitalist hegemony: Without autonomy, there can be no strategy" (Hui, 2016).

In 2013, at the Third Plenum of the 18th CCP Congress, Xi explained that his strategy combined a *decisive role* for the market in the allocation of resources with a *leading role* of the state sector, continuously increasing its vitality, controlling force and influence (Lardy, 2019).

In the aftermath of the financial crisis, even before Xi, China implemented an industrial policy targeting technological leadership (not only catch-up) in cutting-edge sectors. These policies started in 2005 and "were fully in place by 2008-2010" (Naughton, 2021). What is specific of Xi is the assertiveness in foreign affairs and the changes to the political model (e.g., no presidency term limits), but not the industrial policy.

Naughton defines *industrial policy* as "any type of selective, targeted government intervention that attempts to alter the sectoral structure of production toward sectors that are expected to offer better growth than would occur in the (non-interventionist) market equilibrium". For him, China did not have an industrial policy until 2006, but things changed with the medium- and long-term program (MLP) of science and technology "which laid out a fifteen-year program

from 2006 through 2020. The MLP was not in itself an industrial policy, but it contained within it seeds that would grow into a full-fledged industrial policy over the next several years" (Naughton, 2021). The MLP grouped together "nine civilian and seven military/dual-use Megaprojects, 13 of which are known to the public while three remain unpublished". After 2009, the financing was stepped up and the "effort was finalized by late 2010 with the rollout of the Strategic Emerging Industry (SEI) program" (Figure 33).

Figure 33. Sectoral targets of industrial policy

16 Megaprojects (2006-2015)		20 Strategic Emerging Industries (2010-2020)
		Energy Conservation and Environmental Protection
		a. Energy efficient machinery
1	1 Water pollution control and treatment →	b. Environmental protection
		c. Recycling and Re-utilization
2	ULSI Semiconductor Manufacturing	**Next Generation Information Technology**
3	Next generation broadbrand wireless →	d. Next generation internet
4	Core electronics and high end software →	e. Core electronic components
	↘	f. High end software and information services
		Biotechnology
5	Mayor New Drug Initiative →	g. Biopharmaceuticals
6	Major Infection Desease Initiative	h. Biomedical engineering
7	Genetic transformation and plant breeding →	i. Biological Agriculture
		j. Bio-manufacturing Industry
		Precision and High-End Machinery
8	Large Passenger Aircraft →	k. Commercial Aircraft
9	High-Resolution Earth Observation System →	l. Satellites and Applications
10	Manned Space Flight and Lunar Landing ↗	m. Railroad and Transport Machinery
		n. Marine Engineering Equipment
11	High-end Numerically Controlled Machine Tools	o. Intelligent Manufacturing Equipment
		New Energy
12	Large-bed Oil & Gas; Coal Gasification	p. Wind Power
13	Large High-Pressure Nuclear Reactor Technology	q. Solar Power
		r. Biomass Energy
14-16	Three Undiscloser Military Projects	**New Materials**
		s. New Materials
		New Energy Vehicles
		t. Electric Vehicles & Plug-in Hybrids

Source: (Naughton, 2021)

The logic was that "because of the absence of entrenched incumbent firms or countries, these industries are seen as providing competitive opportunities. SEI thus reflects the insight that new industries present an opportunity for leapfrog latecomer development" (Naughton, 2021).

The current industrial policy was only fully formulated in 2015-16 when *Made in China 2025* and the *Internet Plus* program were launched together with "a new integrating vision, a kind of master plan, entitled the *innovation-driven development strategy* (IDDS)". SEI "was reconfigured to make it more operational, coherent and consistent with the IDDS", which focuses on the confluence of communications, data and artificial intelligence (e.g., 5G, smart infrastructure, remote surgeries) and is built upon the idea that "a group of revolutionary new

technologies that are intelligent, green and ubiquitous are reshaping the global competitive landscape and changing the relative strength of nations" (State_Council, 2016).

China uses traditional steerage mechanisms, but also created a new family of instruments. The *Government Industrial Guidance Funds* are Government-backed Venture Capital investment funds (although not only driven by their *return on investment,* like in the west). These were endowed with USD 1.5Tr until 2020 and represent the "greatest single commitment of government resources to an industrial policy objective in history" (Naughton, 2021).

In its quest for sustained economic growth, China also reversed its OFDI strategy in 1999 and launched the 走出去战略 *Going out* policy, encouraging Chinese firms, particularly SOE, to invest abroad. This policy was in effect in 2001, when China joined the WTO. The objective was to take advantage of China's massive FX reserves (diversifying away from low-return American T-bonds) and use FDI to gain access to IP, technology, know-how, and famous brands "in order to move Chinese firms up the value-added chain in manufacturing and services, boost domestic innovation and development of Chinese brands, and help Chinese firms (especially SOEs) to become major global competitors" (Morrison, 2019). In 2006, China launched the China Investment Corporation (CIC), a Sovereign Fund with USD 200Bn, but it was in the aftermath of the financial crisis that it initiated its shopping spree overseas. The BRI is seen by some analysts as an all-encompassing slogan introduced in 2013 to label a phenomenon which was already underway (Kroeber, 2020). But it is more than that from a foreign policy standpoint, as we discus in the next subsection.

All in all, China made an astonishing progress over the last decades (Figure 34) and became a confident economic power with a very high level of state intervention and steerage.

Figure 34. China's economic performance since the reform and opening

	~1980	2005	2019	Source
Gross Domestic Product (GDP) Current USD. Bn	150	2.286	14.280	World Bank
GDP Per Capita Current USD	195	1.753	8.879	World Bank
GDP growth rate %	7.83	11.40	5.95	World Bank
Credit to non-financial corp./ GDP %	NA	145	259	FRED
Foreign Exchange reserves USD. Trillion	0.01	831	3.222	Knoema
Income inequality - Gini coefficient 0 = complete equality; 1 = complete inequality	0.3	0.48	0.46	CEIC
Proportion of State in the economy %	NA (>90?)	43	44	Gavekal
Population in poverty %. Below USD 1.9/day	>70	18.5	<0.5	World Bank
Trade balance As % of GDP	2.7	5.8	1	Worldbank
Corruption Ranking	NA	80th	78th	Transperency

Source: By the author, based on multiple sources

It may surpass the USA as the #1 economy in the world by 2026 (Elegant, 2021), or in the following decade as most analysts predict, but independently from that, it already operates a more balance economy (Lardy, 2019) and holds a remarkable stock of economic power in line with its share of global GDP. This includes OFDI, Trade, Aid, Sovereign Debt, etc. (Figure 35).

Figure 35. China's economic power stock in 2019

	2019		2019
Outward FDI (OFDI) stock UNCTAD Nominal USD. Tri	2.1	Share of Global GDP World Bank %	17.9%
Share of global OFDI stock UNCTAD %	6%	Contribution to global GDP growth World Bank %	32%
Exports World Bank. As % of GDP	18.4%	Development Aid Nominal USD. Bn	4.4
Share of global trade % share of global exports	13%	US Government Bonds USD. Trillion	1.1 (4% of total)
Superior interdependence Countries to whom is #1 export partner	35	Monetary weight RMB share of global payments	2.25%
Participation in Fortune 500 # of Chinese companies (include HK, Taiwan)	129	Military budget CSIS. Nominal USD. Bn	178

Source: By the author, based on multiple sources

3.a.iv. The Foreign Policy of China

To understand the Chinese foreign policy and its implications to our topic, it is helpful to recap what we have seen so far:

- The cultural background tells us that the most plausible scenario is that China will not be adopting Western concepts of individual freedom any time soon and hoping for that to happen has already proven to be misleading;
- China's geopolitical conditions (vast territory with 20 terrestrial and maritime neighbors) make territorial integrity and securing strategic space its strategic priority;
- The American-led Western engagement with China enabled an economic miracle without precedent which cannot be undone and provided the CCP with economic power to buy China's way up the hierarchy of comprehensive power;
- China became an engaged international actor, both multilaterally and bilaterally, and does so without imposing its moral conceptions onto others, which is a powerful competitive advantage *vis-à-vis* the Western quasi-missionary engagement.

The Chinese leaders' conundrum is how to acquire strategic space without confronting the USA (Brown, 2017), whereas the USA keeps insinuating a Thucydides trap rhetoric, ignoring many differences between today and ancient Greece, including the nuclear arsenals and mutually assured destruction (MAD) (Cunha, 2012). At the same time, while non-American Westerners empathize with USA's frustration with China's rise, *real politik* incentivizes them to hedge their bets (i.e., engaging with both simultaneously).

We saw that Xi has pursued "greater power for himself, a larger role for the CCP in the economy and society, heightened regulation of information and capital, and a more assertive foreign policy" (Zakaria, 2020). Xi's China has a coherent grand strategy with guidelines

> "articulated by the leadership, and actions aimed at defending its interests and achieving important long-term goals. China is clear about its core interests and goals: the CCP

> remaining in power; ensuring economic and social development to achieve the twin centenary goals; achieving reunification; and state sovereignty and territorial integrity. China sees the US and its alliance system and dependence on foreign resources, particularly energy, as the biggest threats to these goals and interests. (Norton, 2015).

Indeed, China's national defense goals are enunciated in the official 2019 paper:

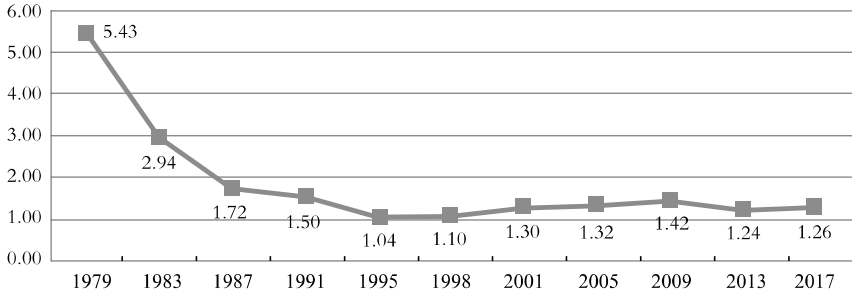
- "to deter and resist aggression;
- to safeguard national political security, the people's security and social stability;
- to oppose and contain 'Taiwan independence';
- to crack down on proponents of separatist movements such as 'Tibet independence' and the creation of 'East Turkistan';
- to safeguard national sovereignty, unity, territorial integrity and security;
- to safeguard China's maritime rights and interests;
- to safeguard China's security interests in outer, electromagnetic and cyber spaces;
- to safeguard China's overseas interests; and
- to support the sustainable development of the country" (State_Council, 2019).

On the defense side, the application of the *one country, two systems* in Taiwan and HK, the stability of Tibet and Xinjiang and the control of the surrounding seas are the priority. Despite the economic co-option of the populations, both Taiwan and HK are political (and security) time bombs – in both cases, the two "jurisdictions have legal systems that are rooted in opposing ideas: Leninist authoritarianism and liberal constitutionalism" (Chan & Londras, 2020). The interdependence with the global economy demands secure sea lines of communication and effective redundancies: "The Indian Ocean, plagued by piracy in both its western and its eastern flanks and with a potentially hostile India square in its middle, was a primary area of Chinese concern" (Garver, 2016). Therefore, China works towards strengthening its comprehensive power, as a mix of economic, military and political power (Cunha, 2012). The military component is not our focus. Nevertheless, it is important to know that the Chinese military power is regionally focused and more defensive than offensive. China fears to be dragged to a conflict with the USA and be defeated. At the same time, its nuclear arsenal, dully protected in the Hainan bases (Garver, 2016) ensures that "Beijing has sufficient nuclear capacity to assure

MAD and create deterrence to reduce the risks of any direct conflict" (Sheng, 2020) with any adversary. It is important to be aware of the debate unleashed by *The China Dream (2010),* a provocative book by the retired Colonel Liu Mingfu. Following the growing *Thucydides trap* rhetoric, it argues that "to guarantee its peaceful rise China needed to build military power superior to that of the USA", which takes decades to achieve. The domestic public debate and its foreign coverage led the "PRC leaders of the Hu Jintao era to fear that this book would injure Sino-US relations" (Garver, 2016).

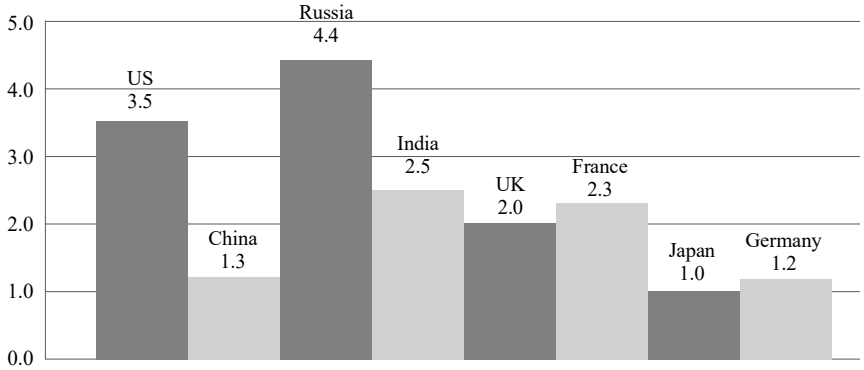
In relative terms, and according to official figures, China has been investing but less than its peers, with defense expenditure below 2 percent of GDP since the early 1980s (Figures 36-37).

Figure 36. China's Defense expenditure as % of GDP



Source: (State_Council, 2019)

Figure 37. Defense expenditure as % of GDP in 2012-17



Source: (State_Council, 2019)

The history of the PRC's foreign policy can be broken down in ten periods (Shambaugh, 2012). The 1949-1957 period was about international isolation (except for the USSR and North Korea). From 1958-1965 China breaks up with the Soviets and reduces the belligerent stance in

exchange for a communist and a third-world rhetoric. From 1966-1970, at the height of the cultural revolution, China backtracked to isolationism, but from 1971-1978 it prepared the opening with the approximation to the USA, the joining of the UN and the opening of embassies throughout the globe. From the Western perspective, China was a critical counterweight to the USSR, the #1 enemy of the time. The 1979-1981 period is associated with the preparation of Deng's opening strategy, which was materialized in the period 1982-89, including a rapprochement to Moscow. The period of 1989-1997 is marked by a third moment of isolationism which started with the Tiananmen crisis (1989) and, despite gradual recovery, lasted until the 1997 (including the turbulence of the Taiwan crisis of 1996-97) when the Asian crisis offered an opportunity to re-engage with its neighbors and the West. The end of the century is marked by the early signs of a *China Threat* school to which the CCP answered with domestic patriotic education centered on victimization for the *century of humiliation* (Carriço, 2018). Suddenly, the successful accession to the WTO, the attack on the Twin Towers, and the subsequent War on Terror overshadowed the *China Threat* dynamics and allowed for an unrestrained integration with the global economy and the rise to an economic superpower. Hu steered the country through a golden decade, and his leadership increased the engagement with multilateralism and attempted to position China as the *Soft Power*, in contrast to the European *Normative Power* and the American *Hard Military Power* (Shambaugh, 2020). In the UN, China behaved responsibly, despite privileging stability over interference and seldom using its veto rights, namely when the topic was not close the American heart and when there were several nations aligned with it (Wuthnow, 2013). China has been enthusiastic about the G20 and the ASEAN. The Shanghai Cooperation Organization "has become a kind of model for a multilateral security organization for the Chinese government" (Breslin, 2010).

Ever since Tiananmen, "domestic HR conditions in China were the main objects of global concern" (Breslin, 2010). China responded to outside pressures with three main tactics: (1)

argumentation with the accusers denying the abuses; (2) tactical concessions such as signing existing treaties; and (3) introducing "domestic legal reforms that, if fully implemented, would be conducive to improving levels of protection" (Breslin, 2010). These made China more confident and more dismissive of external criticism. Recently, the foreign attention moved to China's permissive behavior towards HR abusing governments (Breslin, 2010). But China is aware that it gained a competitive advantage around non-interference and non-proselytism and is not interested in wasting it.

The financial crisis marked the embarkment on a shopping spree in the West, but Obama's *pivot to Asia*, which had a strong military component (Ford, 2017), gave strength to the *hawks* defending regional territorial assertiveness. Since its early steps, such movements had a negative impact, erasing the public diplomacy gains obtained until then (Carriço, 2018): "During the Global Financial Crisis in 2008, China felt even more emboldened. But it probably overplayed its hand, pushing its neighbors around over the maritime border disputes in 2009 into 2010, and creating too much bad feeling" (Brown, 2017). Xi went beyond its predecessor: "while provocative actions by China and other claimants in the South China Sea were commonplace […] Beijing's massive land reclamation and militarization of the islands in the South China Sea did not begin until 2014" (Economy, 2018). But, to be fair, excluding the brief invasion of Vietnam, China has risen pacifically for global standards:

> "China is a remarkably restrained nation on the geopolitical and military front. It has not gone to war since 1979, when it briefly invaded Vietnam. Nor has it funded or supported proxies or armed insurgents anywhere in the world since the early 1980s. That record of nonaggression is unique among the world's great powers. All the other permanent members of the UN Security Council have used force many times in many places over the last few decades – a list led, of course, by the USA." (Zakaria, 2020).

China's foreign policy making is made by three governing actors – the Party, the Government, and the Military (Breslin, 2010). The Central Foreign Affairs Leading Small Group (FALSG) and the Central National Security Leading Small Group (NSLSG), which share the same

administrative staff in the Foreign Affairs office of the CCP CC are highest decision-making forums, but the 30 departments of the Ministry of Foreign Affairs play a central technical role in policy implementation (Cunha, 2012).

The paramount leaders and other senior leaders "have always played a crucial role in setting China's overall policy direction, determining China's national security strategy and managing international crisis" (Shambaugh, 2020). But "they have to rely on the opaque and behind-the-scenes coordination organs to work through a large number of bureaucratic agencies of the state, party and military, whose primary roles are information gathering, and the implementation and recommendation of the policy" (Shambaugh, 2020). Beyond the Ministry of Foreign Affairs, the agencies involved include the Foreign Affairs Committee of the NPC, the Foreign Affairs Committee of the State Council, the Ministry of Commerce, the People's Bank of China, the Ministry of Finance, the Ministry of state Security, the Xinhua News agency and several Party departments such as the International Liaison Department, the Propaganda Department, the UFWD and the PLA (Shambaugh, 2020).

Before Xi, only three Central Foreign Affairs Work Conferences took place (in 1971, 1991 and 2006), and in a relatively small scale. With Xi, these conferences already took place twice (2014 and 2018), are meant to establish "the guidelines, basic principles, strategic goals and major mission of China's diplomacy in the new era", and deserve massive attendance:

> "the entire PBSC, plus ex-oficio member VP Wang Qishan, together with all other 18 Politburo members, and the senior officials in the entire Chinese foreign, security, military, economic, trade, finance, cyber, intelligence community, as well as the central think thank community and nearly all Chinese Ambassadors." (Shambaugh, 2020).

Circling back to Chapter 2, Chinese relations with the world are explained by a permissive combination of power and ideas seated in norms, identities and morals, in a *realist-constructivist* dialectics:

> "no neoliberal scholar can deny the influence that material capacities play in the prosecution of gains based on cooperation. No realist scholar can deny the importance

> of soft power in strengthening the hard power, and no constructivist scholar can deny that the material capabilities and the cooperative arrangements are critical for the elaboration of narratives and discourses." (Carriço, 2018).

After decades of respecting the passive diplomacy (*bide time, hide brightness, do not take the lead*) prescribed by Deng, Xi exhibited increased confidence, proactiveness and articulation from day one (Shambaugh, 2020). China was a victim of its own success (Carriço, 2018): it became "too big to be fluffy", says Dr. Lacerda Machado, interviewed for this thesis. Xi has long believed that China had a communication problem, even if soft power could not be the solution to all problems (Carriço, 2018). For Xi, foreign policy is a priority, and he is personally involved in diplomacy (Shambaugh, 2020). Xi imprints three changes to the world order: (1) China "is imputed with power and strength and purposefulness"; (2) six centuries after Admiral Zheng He, China becomes an ambitious sea power, with the "ability to project power beyond its land borders"; and (3) China becomes a "maker of rules as much as an observer of them", not proselytizing but assuming its preference for "harmony, multipolarity, non-interference and balance". Xi wants to engage in great power politics (Brown, 2018).

From the organizational standpoint, Xi created in 2013 a new State Security Commission (SSC), with "comprehensive authority to consolidate the party's core and Xi's personal control of China's vast security apparatus and to cope with both domestic and external security issues, both traditional and non-traditional issues, and both development and security issues" (Shambaugh, 2020). In 2018, Xi upgraded the FALSG to Central Foreign Affairs Commission (FAC), in an attempt to formalize its power and increase the prominence of foreign affairs (Shambaugh, 2020). The FAC is led by the highest-ranking political diplomat Yang Jiechi. His promotion to the Politburo proves the importance of foreign policy in the new China: "In the Hu era, the foreign minister was usually one of the least prominent figures in the party" (Brown, 2018). With Xi, the highest-ranking officer dealing with foreign affairs is Wang Huning, a

member of the PBSC, first-ranked secretary of the Party's Secretariat, and the actual architect of the ideologies of Ziang Zemin, Hu Jintao and Xi Jinping.

The *Going Out* policy was launched in the turn of the century, but COFDI reached its climax under Xi, becoming a cornerstone of China's economic/foreign policy game (see Chapter 4).

The BRI initiative is "Xi's signature foreign policy initiative […] closely associated with Xi's promised *China Dream* of national rejuvenation" (Garver, 2016). The claims in the South China Sea are the only initiative with parallel importance. The BRI overlaps with COFDI but is not confined in it, also including loans and construction contracts in specific industries and partner countries. It is core to the creation of a Sinocentric order and addresses many economic/foreign policy challenges at once (see Figure 38 for its drivers and implications).

Figure 38. Drivers and implications of the BRI

Chinese motivations to BRI	Problem or opportunity	Solution	Implication
Economic	• Need to open new export markets to continue growing its GDP • Chinese economy and SOEs plagued by overcapacity and history of social tension when downsizing • Excessive FX reserves invested in low-yield assets (US bonds) • Desire to internationalize the RMB	• Opening new markets for Chinese exports of products and services (e.g. construction) and follow its standards • BRI projects financed Banks and multilateral Funds controlled by China • Acquire foreign corporations or provide debt collateralized by the hard assets • RMB denominated debt	• Enable the **success of the Chinese economic model** based on State-controlled enterprises, large scale and low cost labour • Maintain **high growth rates** • **Geographical diversification** of investments and trade counterparts
Strategic	• Navy constrained for deployment in the surrounding seas (including nuclear); • Dependence on logistical chokepoints controlled by other powers (e.g., USA) • Instability in poor interior regions with large secession-prone minorities • Unstable neighbours without government in full control of the territory • Need to avoid confrontation with the USA; • Central Asia neglected by others	• Acquires strategic space through the creation of economic mutual interests • Creates alternative supply chains both terrestrial and maritime • Stabilizes its interior and neighbours through economic development • Engages with governments independently from political regime • Use economic instruments in the pursuit of strategic objectives	• Secure **regional comprehensive supremacy** • Guarantee **access to energy, food and other critical inputs** • **Limit secession** movements and mitigate **terrorist threats** and disruption • **Deny the Washington consensus** and the end of history • Political influence in other countries?
Greater good	• China has been of the major beneficiary of the globalized economy	• China finances offering of infrastructural public goods	• Creation of an *harmonious world* and spread the benevolence of China

Source: By the author, based on several authors, including (Rolland, 2017), (Shambaugh, 2020), (Garver, 2016), (Economy, 2018), (Markey, 2020), (Brown, 2020).

As it shows, the economic motivations of sustaining the Chinese economic model could be sufficient to support the initiative, but they are not alone. Even the official rationale of supporting the provision of public goods does not tell the whole story. There is ample evidence to suggest that strategic considerations, including the securitization of its Western flank (Duarte, 2017), also explaining the centrality of BRI. What is still to be proven is China's acquisition of decisive political leverage over the recipient countries. On the contrary, Sri Lanka and Maldives

are examples where the change of Government left China politically empty-handed. At the same time, China is confident that the returns "can sometimes be measured in increased *friendship*" (Rolland, 2017), often called goodwill.

The BRI is an upgraded spin-off of the *Going Out* policy focused on the Eurasian continent and its adjacencies. The BRI focuses more on infrastructure, telecom, energy, transport and logistics, whereas COFDI in the EU and the USA (namely since 2017) focuses on technology and services (Economy, 2018). It was originally conceived

> "around six main *corridors* of economic integration across Eurasia […] Beijing has dubbed its land-based corridors as the *Silk Road Economic Belt* while sea-base routes fall under the *21st Century Maritime Silk Road.* The *Digital Silk Road* covers the Internet as well as its associated networks of fiber optic cables and satellites. In January 2018, China even extended the BRI to the Artic with the *Polar Silk Road"* (Markey, 2020).

BRI's working process follows four steps: (1) the recipient countries decide to participate; (2) they detail and present projects which could be included in the initiative; (3) the Chinese government negotiates with the recipient government; (4) a Chinese financial institution finances the project (Garver, 2016). In parallel, China has supported the emergence of new multilateral financial institutions which join the Chinese development banks (e.g., CDB, Bank of China) in financing the BRI projects. The most important of these institutions are the Asian Infrastructure Investment Bank (initially USD 50 Bn), the Silk Road Infrastructure Fund (initially 40 Bn) and the New Development Bank (initially USD 40 Bn). The sequence mimics a logic of suzerainty, where the beneficiaries go to Beijing asking for China's support, which is conceded as a sort of gift.

The port of Gwadar in Pakistan is illustrative. Connected to China via the massive Karakorum highway, the port is seen as a Chinese idea to reach the Indian Ocean by land, reducing the dependence on Malacca. In fact, researchers have surfaced that this was an old idea from Musharraf (2001), while China always saw it as "a white elephant with little commercial necessity, disconnected from Pakistan's transit and communications networks, and surrounded

by impoverished fishing villages as well as, more menacingly, Baloch separatist groups waging a decades long insurgency against the state" (Markey, 2020). It took China one decade to get comfortable with the project's risk.

BRI has different impacts to different groups of countries (Figure 39).

Figure 39. China's relations with Asian countries and the BRI

	Nature of the relationship with China	The impact of BRI in the relationship
Russia	• Proximity makes it China's #1 priority in Foreign Policy, and the relationship has had severe ups and downs through history • China understands that Russia is a military state and the way to be respected by it is to have a strong army and engage economically a logic of exploiting comparative advantages and natural endowments	• Russia was the dominant power in Central Asia and still holds critical influence - BRI can only fly there with Russia's blessing • China focuses on transport & logistical developments in the Russian corridors, increases trade with China... and complements it with joint military exercises
Japan, Korea	• These countries have reached impressive economic development and the wing (economically and militarily) of the United States • The economic engagement with China is very important for their economies but history ensures a perpetual security tension	• Japanese and Korean companies stand to loose space in Central Asia if their governments are not officially supportive of the BRI • South Korea is a partner of the BRI (2018) but Japan is not; Korea cannot afford to distance itself, whereas Japan can, with caution
Vietnam, Malaysia, the Philippines	• These countries have in China a critical trade partner and are too weak to be in bad terms with China • At the same time, the maritime territorial disputes are critical political issues at home, and governments need to show determination	• These countries are thirsty of infrastructure development • These cannot afford to pick sides in the Asian power struggles • All these countries joined the BRI in 2017 and are actively competing for accessing as much funds as possible, with caution
India	• India is an American Ally and have in China and Pakistan its main security threats (with ongoing border disputes) • The relationship with China is increasingly one of rivalry • For both reasons, their default relation will remain of suspicion	• India is not part of the BRI and stands to be its biggest loser • India's dominance of the Indian Ocean is severely undermined in both economically (China's goods and services gain easier access) and military terms (e.g. through dual usage of infrastructure)
Pakistan, Bengla-desh, Myanmar	• These countries have in China their best opportunity to have a big brother that protects them from American and Indian enmities • Low development level increases their appetite for Chinese products and services - commercial engagement is mutually beneficial	• These countries are thirsty of infrastructure development, but also for integrating Chinese supply chains and also acquiring Chinese products • They are actively engaged with BRI and are its biggest winners
Maldives, Sri Lanka	• China is a very important trade partner to these countries and provides important flows for tourists; At the same time, these countries need to remain neutral in China's quarrels with India/USA	• Both countries have been actively involved with the BRI but also associated with the concerns over the so-called debt trapped, which is still a buzz word in the media but less worrying for scholars
KSA, Iran	• China is the main energy importer from both countries	• Both countries engage with the BRI despite the enmity between then

Source: By the author, based on several authors, including (Rolland, 2017), (Shambaugh, 2020), (Garver, 2016), (Economy, 2018), (Markey, 2020), (Brown, 2020)

3.b. Primer on the EU

3.b.i. Past and present of the EU integration

The EU was formally established in 1993, after the Maastricht European Council of 1991 agreed on the Treaty of the European Union (TEU), which was signed in 1992. In practice, the story starts soon after World War II.

There is vast literature about the EU and its integration process, ranging from federalist fanaticism to the critical theories, which argue that the EU institutions and academic theories are captured by the most powerful states and an elite of euro-bureaucrats (the *Brussels bubble*) detached from the citizens and the smaller states. The EU is a *sui generis* institution and the conventional EU studies developed in isolation within IR, going "their own way, without linking their conceptual and theoretical approaches to the general IR literature" (Forsberg, 2013). Its scholars failed to anticipate the effects of the financial crisis and the EU institutions continued pressing forward (e.g., through the Constitutional Treaty attempt) in a technocratic, quasi-automated thrust perceived by the EU citizens as arrogant and illegitimate: "Critics, not just Eurosceptics, have suggested that the determination to press on with reforms apparently rejected in 2005 was a piece of arrogance that was either mindless, or a deliberate attempt to foist a superstate in the nations and peoples of Europe" (Church & Phinnemore, 2019). Simultaneously, "the way people write and talk about Europe is partly responsible for the lack of interest in the subject – specialist language not only allows people to hide behind empty words (which is bad enough), it often serves as smokescreen, concealing rather than explaining political moves and power plays" (Middelaar, 2013). The implication is the aggravation of Euroscepticism and its exploitation by domestic politics.

The EU is "a family of liberal-democratic states, acting collectively through an institutionalized system of decision-making" and its members adhere to "the body of EU treaties, legislation and

norms" and "to a set of shared common values, based on democracy, HR and principles of social justice" (Cini & Borragán, 2019). It is a hybrid body, somewhere between an international organization and a state, and it is unclear if it is moving towards more integration or disintegration, both in term of depth and breadth of membership.

The EU budget is decided on a multi-annual basis, through negotiations that last "several months if not years and are always highly technical", and is financed by customs duties and sugar levies, a percentage of the value-added tax collected in the member states, and national contributions of 1 percent of Gross National Income (Cini & Borragán, 2019).

There are five main *modes* of EU decision-making: (1) the classical community method; (2) the regulatory mode; (3) the distribution mode; (4) the policy coordination mode; and (5) the intense transgovernmentalism (Cini & Borragán, 2019).

Despite the attempts to create an EU identity, the member states' national identities are incommensurably stronger: "Identification with Europe does exist, but it is a complex phenomenon, framed in several ways and does not necessarily imply support for the EU" (Papadogiannis, 2019). There is a shared history, but one plagued by war and rivalry. There is a Judeo-Christian root, but appealing to it alienates several constituencies (agnostics, atheists, Muslims, etc.). There are successful initiatives aiming at promoting the citizens' association with the EU, such as the *Erasmus Program*, which enabled ~10 million students to go abroad since 1987. The EU provides several potential benefits to its populations, such as free trade, free movement, consumers' protection, supra-national protection from abuses, etc. But, in practice, these advantages are mostly accessible to a minority, the so-called *anywheres* (defined in opposition to the *somewheres*). The individuals in the first group, which are approximately one third of the population, are people with "portable *achieved* identities, based on educational and career success which makes them generally comfortable and confident with new places and people" (Goodhart, 2017). They do well at school, go to university and speak foreign languages,

appreciate and take advantage of the EU passport, the single currency and the enlarged market. They dominate "the culture and the society" and are a recruiting base for the power elites dominating the system. Conversely, the *somewheres* "are more rooted and usually have *ascribed* identities […] based on group belonging and particular places, which is why they often find rapid change more unsettling". Importantly,

> "one core group of *somewheres* have been called the *left-behind* - mainly older white working-class men with little education. They have lost economically with the decline of well-paid jobs for people without qualifications and culturally, too, with the disappearance of a distinct working-class culture and the marginalization of their views in the public conversation" (Goodhart, 2017).

The national legitimacies are stronger than that of the EU institutions and events like "the Brexit vote largely reflected the discontent of the *left-behind* and a demand to regain control over key policies" (Cini & Borragán, 2019).

Maintaining peace was the #1 objective of the EU's founders and getting back on their feet economically was #2. Peace is no longer a concern for most states, and Western Europe is plagued with economic stagnation. Middelaar argues that the EU tried, without success, three identity-building strategies: the *German strategy*, focused on a shared cultural/historical identity of *our people*; the *Roman Strategy*, based on the appeal of a functioning political system which offers protection, opportunities, money, etc for *our advantage*; and the *Greek strategy*, which ensures *our own decision* based on "periodic appraisal by the population of representatives who take decisions on their behalf" (Middelaar, 2013).

Belgium, France, West Germany, Italy, Luxembourg and the Netherlands, initiated the European integration process in 1951 with the signing of the Treaty of Paris and the establishment of the European Coal and Steel Community. This created "Europe's first supranational institutions: the High Authority, the Common Assembly, the Special Council of Ministers, and the Court of Justice" (Phinnemore, 2019). The 1950s witnessed the failed attempt to create a European Defense Community and a European Political Community, but also the

successful establishment of the European Economic Community (EEC) in 1957. With the Treaties of Rome, the six members committed to a Customs Union, "but also to the adoption of common commercial, agricultural and transport policies and the establishment of a common market with common rules governing competition" (Phinnemore, 2019). It also created new institutions: a Commission, an Assembly, a Court of Justice, and a Council. In 1960, Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK established the European Free Trade Association. The integration stalled in the 60s when France refused to attend Council meetings until there was a mechanism (*the Luxembourg compromise*) which, although not legally binding, "has in effect provided member states with a *de facto* veto over Council decisions" (Phinnemore, 2019). Denmark, Ireland and the UK joined the EU in 1973, Greece in 1981, and Portugal and Spain in 1986.

The Single European Act of 1986 amended the Treaties of Rome, going beyond the single market and the expansion of the qualified majority vote in the Council, namely the decision to move towards the EU, which was set in stone with the TEU. Among other changes, it determined the creation of the European Monetary Union (EMU), created the European Central Bank and upgraded the Court of Auditors to an institution. A three-pillar structure was created, which was adjusted with the Treaty of Amsterdam in 1997: the first pillar was the *European Communities*, the second pillar was the *Common Foreign and Security Policy* (CFSP), and the third pillar was first the *Justice and Home Affairs*, later changed to *Police and Judicial Cooperation in Criminal Matters*. Meanwhile, Sweden, Finland and Austria joined in 1995. The Treaty of Nice, signed in 2001, was meant to pave the road for the new members which joined in 2004 (Czech Republic, Estonia, Hungary, Poland, Latvia, Lithuania, Slovakia, Slovenia, Cyprus and Malta), 2007 (Bulgaria and Romania) and 2013 (Croatia). The Nice European Council of 2000 started the *Future of Europe* debate which led to a failed attempt on a Constitutional Treaty. The EU institutions reached an agreement, but the Treaty was blocked

by the French and the Dutch referenda. This failure surfaced a legitimacy crisis which persists. There was an amending (Lisbon) treaty signed in 2007, which changes to the previous treaties, and then vanishes. The result is the *Treaty on the functioning of the European Union (TFEU)* and an amended TEU, which outlines the EU's aims, objectives, principles and institutional structure. These treaties brought matters in line with the common practice and centered on the EU, which became the sole structure of integration (the Community disappeared).

Apart for the CFSP, everything functions according to the *ordinary legislative procedure* (instead of earlier intergovernmental methods), where the EU Commission (EC) sets the initiatives in motion by presenting proposals to the Parliament.

Among other changes, the qualified majority vote in the Council "was extended to some 60 new instances with a new and simpler double-majority system […] the majority of the member states (55%) and the population that they represent (65%) is required".

The member states "retained emergency breaks in areas such as tax harmonization, the CFSP, Criminal matters and social security" (Church & Phinnemore, 2019). The High-Representative of the Union for Foreign Affairs and Security Policy became a double-hatted VP of the Commission and Chair of the Foreign Affairs Council.

In response to the financial crisis, the Eurozone signed the *Treaty Establishing the European Stability Mechanism* (2011) to allow for the provision of financial assistance, and 25 EU countries signed the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012)* – the so-called *fiscal compact*. The *compact*, which is an upgrade version of the *stability and growth pact*, obliges 22 member states to keep balanced public finances. Nevertheless, Euroscepticism achieved unprecedented levels in the 2010s and the appetite for new treaties and further integration evaporated.

Some authors argue that the evolution of the EU has been driven by the challenges and crises, but "even if crises have (re-)invigorated European integration in the past, this does not mean

that they will continue to do so in the future" (Cini & Borragán, 2019). The 2010s brought a multi-dimensional crisis, encompassing financial and economic crisis, social crisis, refugee crisis, Ukraine/Russia crisis and the Brexit, which jeopardize the existence of the EU. The Brexit created a blueprint for exiting the EU.

Middelaar argues that the EU has recently undergone a metamorphosis. The crisis demanded a change from a rules-based to an events-based dynamic. The public got tired of depoliticized backstage decision-making where faceless experts treat each topic as a technical decision. Instead, they demand front-stage decision-making and political accountability.

In the financial crisis, the rules (i.e., the treaties) ordered that in the imminence of a sovereign default (e.g., by Greece) the EU shall do nothing, which would have been irresponsible. The hardships reformed the political arena, turning it into a *jazz band* where technocratic leaders without individual swing and political acumen lose space to risk-takers willing to stress the system to define its new frontiers (Middelaar, 2019). The EU politics used to be based on political groups and the parliament was even choosing the President of the EC (via the *Spitzenkandidaten* process). The new EU political arena is the Council. In the process, the EU dropped its geopolitical naivety. Sigmar Gabriel (German vice-chancellor and MFA) said that "As the only vegetarian […] we'll have a damned tough time of it in a carnivore's world" (Puglierin, 2019).

In the EU, different policy areas have different decision centers. Some reside in Brussels, some in the member states, and many in a volatile in-between (Pérez, 2020). Regarding the economic engagement with China, the EU and the member states share responsibility. The EU negotiates trade and investment agreements, but the states retain bandwidth and maintain a bilateral agenda. From a geopolitical standpoint, it is even more complicated, because both the EU and the member states have active foreign policies and there is no European army.

3.b.ii. Economic Power and Normative Power of the EU

This subsection presents the current power stock of the EU in comparison to the USA, China, Russia, and the UK. It explains that its economy is its most tangible source of power and that, labels aside, the EU has been presenting itself as a *normative power*. It is ambiguous to talk about the power of the EU because the EU is neither as much as the sum of its parts, nor as little as the largest of its members. Figure 40 presents some proxies for the military, economic and soft power of each bloc. The military power includes the ranking according to the firepower index, the ranking in number of nuclear warheads and if the country seats at the UN Security Council. The economic power is evaluated based on the percentage of global GDP, global trade and global OFDI. The soft power is compared based on *Soft Power 30* and *Brand Finance* rankings.

Figure 40. Power comparison among largest global powers

	Largest military and economic power	Relevant military and economic power	Relevant military power	Relevant power across all dimensions	Largest soft power and relevant economic power; Would be relevant military power if it pooled its capabilities together	
	USA	China	Russia	UK	EU-27 total	Largest EU member state
Military						
Firepower index	1st	2nd	3rd	5th	NA	France 6th
Nuclear	2nd	3th	1st	5th	NA	France 4th
UN Sec. Council	Yes	Yes	Yes	Yes	NA	Yes
Economic						
GDP %/Global	25%	16%	2%	4%	17%	Germany 5%
Exports/imports %/Global	10%/10%	11%/8%	2%/1%	4%/3%	10% excluding intra-EU	7%/5%
OFDI %/Global	22%	5%	1%	6%	31% sum of parts	Netherlands 7%
Soft power						
SP 30 ranking	5th	27th	30th	2nd	1st	France 1st
Brand F. ranking	6th	8th	13th	3rd	1st	Germany 1st
Considerations	Impacted by Trump and COVID management	Weak in the west, stronger in non-liberal democracies	Strong only in its region	Very high	Many EU countries rank very high	Very high

Source: By the author, using (GFP, 2021), (Brandirectory, 2021), (Davenport, 2020); (UNCTAD, unctad.org/topic/investment/world-investment-report, 2020), (Softpower30, 2020)

At the military level, the most important feature is the lack of an EU army, so its power is limited. The EU has a Common Security and Defense policy, which is steered by the High-

Representative. Moreover, it has a Global Strategy, a Security and Defense Plan, and a Permanent Structured Cooperation (PESCO). It deploys targeted military operations and civilian missions. On the military side, it "deploys armed forces and defence capabilities to third countries to deter, prevent and repress piracy and human and arms trafficking networks, conduct surveillance, train partners' military forces and contribute to safe and secure environments and civilian missions". On the civilian side, it "deploys unarmed legal experts, police experts and border and customs officials to third countries to contribute to the rule of law, border monitoring, law enforcement capacity-building and training" (EUISS, 2018).

The EU security and territorial integrity is guaranteed by NATO, of which most EU states are members. For several decades, the EU did not feel the need for a military force outside NATO for three main reasons: (1) no relevant conflicts within the EU or in its neighboring region; (2) the American willingness to finance more than its fair share of the burden; and (3) other political priorities such as the inclusion of new member states and overcoming the financial crisis. The situation has evolved negatively, and the EU faces severe security threats related to terrorism and the flux of illegal migration, while the USA no longer intends to finance NATO disproportionally (Holland & Wroughton, 2019). The EU woke up for its military incapacity in the Kosovo crisis, the terrorism escalation of the last decade and the proliferation of the cybercrime that called for a security cooperation which was not in the horizon. The appetite for a shared defense is slowly growing within the EU even if a common powerful army is not foreseeable. After the Brexit, France is the only member state with global military capabilities. Both the UK and France seat in the security council of the UN and have meaningful nuclear capabilities. Both have relevant conventional military capabilities, but far less than the three strongest powers. Taken together, the EU concentrates 16 percent of global military spending, vs. 40 percent from the USA, 10 percent from China and 7 percent from Russia (Moravcsik, 2017).

The USA is the most powerful nation in this dimension, but Russia and China have enough military capabilities to hold their ground on a regional conflict. From a realist standpoint, Russia is the only nation posing a threat to the EU states. The invasion of Ukraine showed that the EU cannot deal with Russia only through economic statecraft (Forsberg, 2013). Russia is a soldiers' nation, which respects strong armies and engages economically. Taking into consideration the current power stock of the EU, it is "unreasonable to expect the EU to be able to influence Russia on an expansive range of issues" (Forsberg, 2013). Looking beyond Russia, the EU issued a Security Union Strategy (2020) with four priorities (Figure 41).

Figure 41. 2020 EU Security Union Strategy



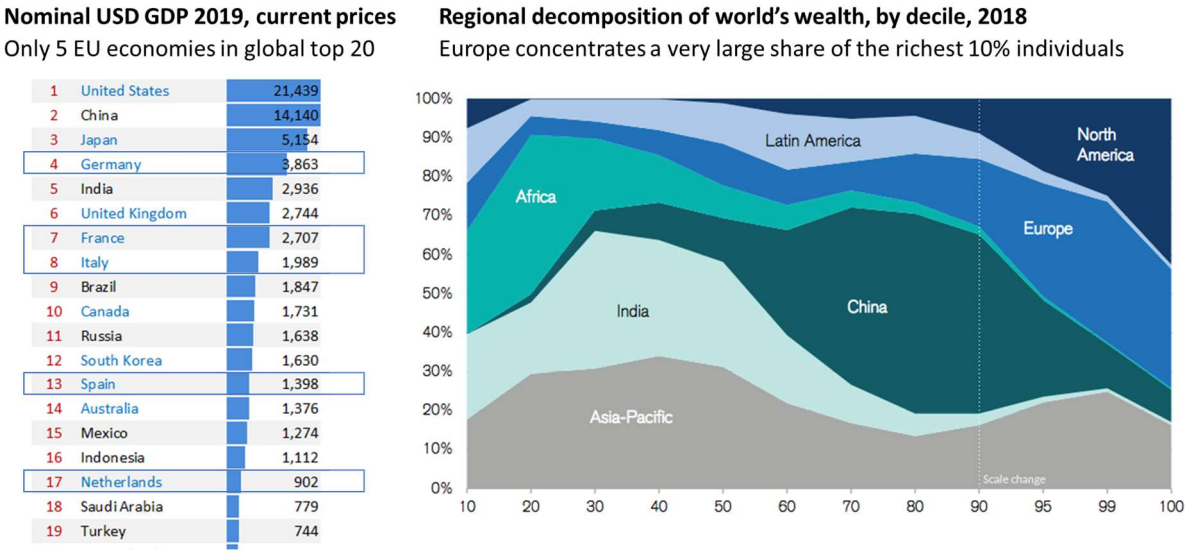
Source: (EC, 2020)

Transnational threats including pandemic, environmental disasters, organized crime, and illegal migration create security threats which cannot be dealt with armies alone. This is "where the EU has a certain advantage in that it can bring to the table an impressive array of civilian and military instruments to tackle these problems" (Cameron, 2012).

The American economy is the largest in the world (~25 percent of global GDP), whereas the Chinese and the sum of the EU economies are ~16 percent each. Among these, the EU is the largest OFDI investor and China is the smallest. The three have very similar trade volumes but the EU has a hard time getting its economic act together. From a realist perspective the EU

states are economic competitors. For the USA, Russia or China, it is better to negotiate with the individual states bilaterally. This does not mean that rising powerhouses like China may not want to enable a stronger EU to help bringing about a multipolar world. Among the top 20 economies, only five are EU states (Figure 42). At the same time, Europe concentrates a disproportionate share of the world's 10 percent wealthier individuals, being the largest affluent market in the world.

Figure 42. 2019 Global income ranking and wealth distribution



Source: (MGM, 2019) and (Davies, Lluberas, & Shorrocks, 2018)

The European FDI is reviewed in Chapter 4, so we leave it for now. The key message to anticipate is that it is the largest OFDI investor globally, and a very permissive IFDI destination, where foreigners can acquire distinctive know-how, technology and brands.

The most used soft power indexes rank the EU extremely high, since the EU includes France and Germany, and each of them leads one of the indexes. *Soft power* "measures the ability to advance foreign-policy goals by disseminating and manipulating ideas, information, and institutions that help persuade other countries to act in particular ways. Soft power is employed by various means, and the EU belongs among the world's most effective manipulators of many of them" (Moravcsik, 2017). The EU does so in several ways. First, the EU is a leader in building and managing multilateral institutions: "One important type of soft power is the

construction of multilateral institutions that are attractive to join. Today, Europeans are the world's leading supporters of global and regional institutions"; second, the EU is one of the two educational superpowers: "27 of the world's top 100 universities are in Europe, compared with 55 in the USA, one in Russia, and none in China. Europe exceeds the USA in educating foreign students, hosting almost twice as many students from outside the EU as non-Americans at USA" (Moravcsik, 2017); other cultural features include sports (e.g., the EU gets more Olympic medals than the rest of the world combined), languages (four EU languages rank top 10 in total speakers: 1st English, 1,32 Bn; 4th Spanish, 534Mn; 5th French, 280 Mn; and 9th Portuguese, 234 Mn), among others (Lane, 2019).

The EU member states are bound by shared common values, not only internally but also externally. The CFSP expressly aims for developing and consolidating democracies, the rule of law and respect for HR. The EU is committed to finding out what it ought to be from an ethical standpoint, which is unique in the world. This is a conceptual feature which poses more questions than offers answers. Already in 2006, Mayer and Vogt were clarifying these questions and demanding the EU to answer them, suggesting six principles incurring responsibilities to help guide foreign affairs from an ethical perspective (Mayer & Vogt, 2006).

The EU ties its hands to a liberal-constructivist approach, whereas its geopolitical competitors are more realist. This poses challenges to those with simultaneous leadership roles in the EU and the local governments because domestically these bounds are generally less of a priority. It should not be surprising that member states seem to upload their conscience to the EU and keep a realist positioning in bilateral relations – this is so by nature. Therefore, it is just a matter of time for the EU to fail on its promises and/or expectations and become (or be seen as) both hypocritical and naive (Cameron, 2012). In relation to this concept, the EU has had several labels, some related to the means used, such as *civilian power* (Duchêne, 1973) or *normative power* (Manners, 2002); others related to its goals, such as *ethical power* (Aggestam, 2008).

Manners' label is probably the most widespread and means to describe the European ability to influence through values and norms, controlling the dominant discourses and action.

Circling back to the IR theories, there are three takeaways to retain for understanding the Foreign Policy of the EU. From a realist perspective, the EU is not a full actor because it is not a state and does not have enough hard power to engage assertively in high politics, so it is more of "a repository of the second-order normative and ethical concerns of its member states" (Hyde-Price, 2008). But the EU is a strong player in other transnational security threats and "there are thousands of EU soldiers engaged in various peace-keeping and crisis management operations around the world" (Cameron, 2012). It is also an economic superpower with its own currency and a key role in international trade negotiations. From a liberalist perspective, the EU is an additional supra-state governance layer, which enables peace and interdependence, strictly interlocked with the domestic politics of each state. From the constructivist perspective, the EU is an extremely institutionalized actor, built upon norms and values that inevitably impact the other actors engaging with it. By definition, the EU sees itself as morally superior and aims to uphold its fundamental values and push them onto others.

3.b.iii. Foreign Policy of the EU

The EU was born without foreign policy and is still in the process of building a coherent one, which presupposes the existence of a coherent strategy and resources to implement it. By strategy, it is meant "a broader framework that can consistently and systematically guide policymaking at various levels […] it entails the existence of a coherent set of goals and ideas that can guide policymakers in dealing with political reality" (Nitoiu & Sus, 2019). With the Lisbon Treaty, the High-Representative became a double-hatted VP of the Commission and Chair of the Foreign Affairs Council, which gave it more political leverage. To support the High-Representative, a European external action service was created, which is fundamental to carrying out the EU CFSP, including the Common Security and Defence Policy (CSDP). The CFSP seeks to preserve peace, reinforce international security, and promote international cooperation, democracy, rule of law and respect for HR and fundamental freedoms (EU, 2021). The CFSP entails diplomacy, negotiations, and mediation, whereas the CSDP entails military and civilian management operations (using contributions by the member states). The European foreign policy is non-exclusive (the member states keep their own foreign policy), and not all-encompassing (needs to take into account the differences between the member states). It is also multifaceted, because the CFSP and the CSDP have intergovernmental decision-making processes, whereas the external action service involves various EU institutions. The existing framework results in a cacophony with limited efficacy, but, until now, the objective has been to search for as common ground as possible, not to have a unified strategy.

The EU Global Strategy of 2016 explains the shared interests and principles which include (1) to "promote peace and guarantee the security if its citizens and territory", (2) to "advance the prosperity of its people" including to "foster the resilience of its democracies", and (3) to "promote a rules-based global order […] with multilateralism as its key principle and the UN at its core" (EU, 2016). The five main priorities are (1) the security of the EU, (2) state and

societal resilience to the east and south, (3) an integrated approach to conflicts, (4) cooperative regional orders, and (5) global governance, aspiring to "transform, rather than to simply preserve the existing system" (EU, 2016).

There is a Political and Security Committee (PSC) which "occupies a central position in the CFSP and the CSDP and is one of the main channels for the member states to control the CFSP. The Committee consists of high-ranking national representatives at the ambassador level". It drafts policy and oversees its implementation. There is also an EU Military Committee (EUMC) which is "the main military body of the EU and is composed of the national chiefs of staff, supported by the EU Military Staff (EUMS)". Finally, there is a Committee for Civilian Crisis Management (CivCom), which "provides information and drafts recommendations to the PSC on civilian aspects of crisis management" (Friis & Juncos, 2019). The Lisbon Treaty reduced the power of the Commission, in the sense that it cannot put forward policy proposals without the joint endorsement by the High-Representative. The EU parliament has even less influence, except for its role in appointing the High-Representative (Friis & Juncos, 2019).

The Common Commercial Policy is a critical policy element which leads trade and investment agreements. According to the Article 207 of the TFEU,

> "The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies […] Where agreements with one or more third countries or international organizations need to be negotiated[…] The Commission shall make recommendations to the Council, which shall authorize it to open the necessary negotiations […] the Commission shall conduct these negotiations in consultation with a special committee appointed by the Council […] For the negotiation and conclusion of the agreements referred to in paragraph 3, the Council shall act by a qualified majority. For the negotiation and conclusion of agreements in the fields of trade in services and the commercial aspects of intellectual property, as well as foreign direct

> investment, the Council shall act unanimously where such agreements include provisions for which unanimity is required for the adoption of internal rules" (EU, TFEU, 2008).

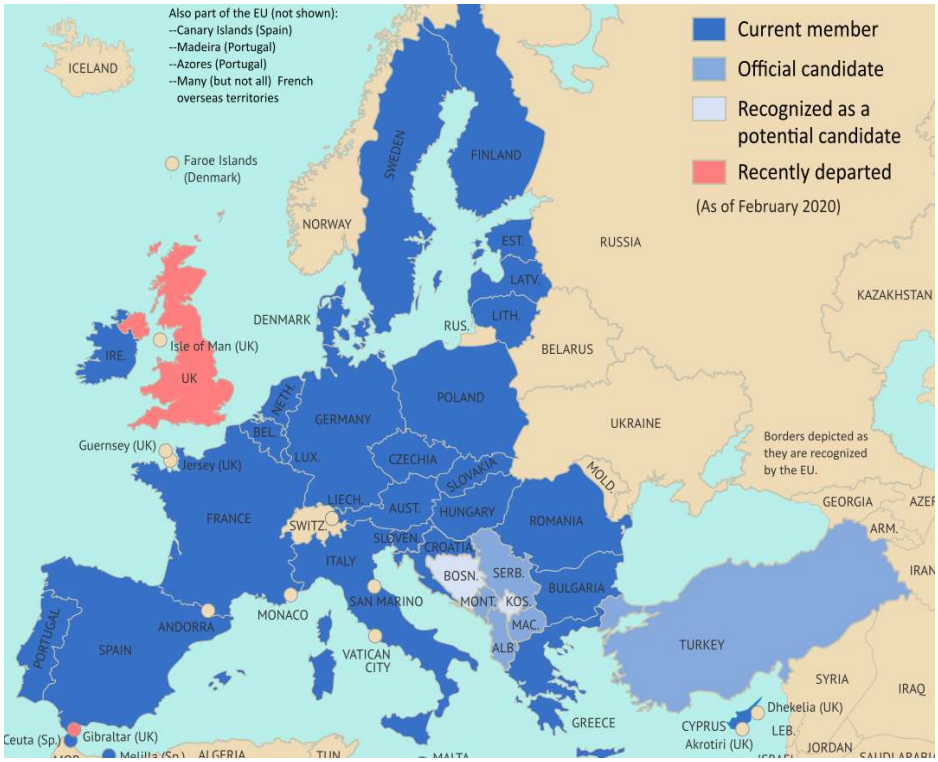
In promoting its prosperity and values, the EU encounters dilemmas. One of them is the ongoing discussion about the CAI with China, which was signed in December 2020, after seven years of negotiation, but its ratification was halted by the Parliament on May 2021 (Emmot, 2021). The EU's effectiveness in this matter should not be exaggerated: "Since the intergovernmental process is still dominant in these domains, speaking about a *European foreign policy* is at the moment an exaggeration" (Andreatta & Zambernardi, 2017). There were multiple situations exposing the divide (e.g., Kosovo crisis, Iraq invasion), which damaged the foreign credibility. The difficulty is that "there is neither agreement among member states nor supranational procedures to aggregate the views and interests of its parts in a single, unified European position" (Andreatta & Zambernardi, 2017). The problem is not so much about the lack of tools because despite not having its own military power, the EU has significant economic statecraft power. No war is conceivable under the "cumbersome decision-making procedures of intergovernmentalism, with 28 or 27 veto powers" (Andreatta & Zambernardi, 2017).

The enlargement process is one of the EU's most important foreign policies. It is not a solidarity mission, but it is missionary. It "has always been, and still is, a quintessential security policy. By extending the Union's norms, rules and opportunities and constrains to the eastern half of the continent – and later to Southeast Europe - it made instability and conflict in the wider region much less likely" (Cameron, 2012). The *Copenhagen criteria* for EU accession demands

> "stability of institutions guaranteeing democracy, the rule of law, HR and respect for and protection of minorities; a functioning market economy and the ability to cope with competitive pressure and market forces within the EU; and ability to take on the obligations of membership, including the capacity to effectively implement the rules, standards and policies that make up the body of EU law (the 'acquis'), and adherence to the aims of political, economic and monetary union" (EU, 1993).

Figure 43 presents the membership status, highlighting official and potential candidates.

Figure 43. EU membership status among European states

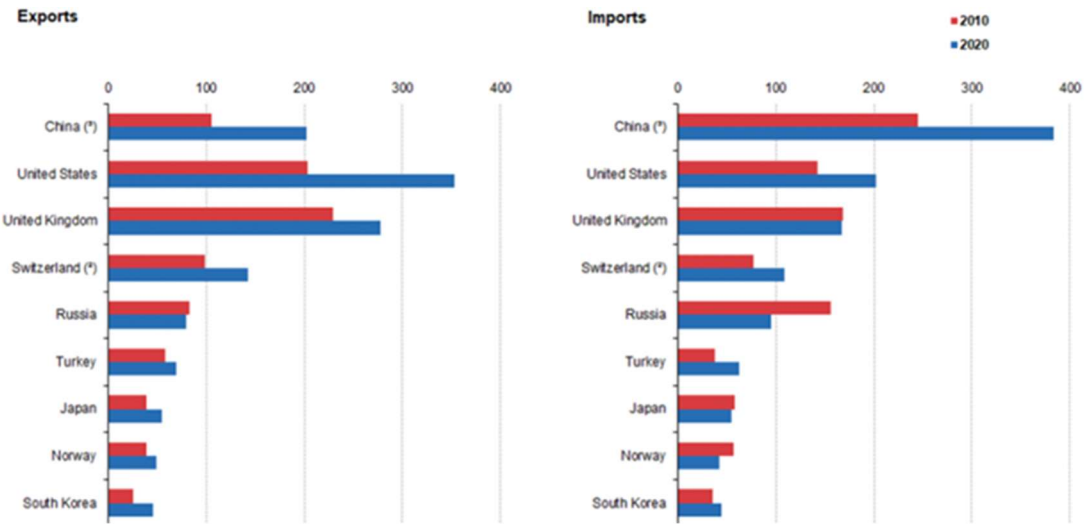


Source: (Centanni, 2020)

Since 2004, there is a *European Neighborhood Policy* and individual action plans for each neighbor, which entail economic support in exchange for political and economic reform. The EU "devotes more time, energy and resources to its immediate neighborhood than any other part of the world" (Cameron, 2012). Nevertheless, the regional power of attraction outside the enlargement process is much lower and the Southern and Eastern neighbors illustrate the incongruences among individual interests. On the one hand, several authoritarian regimes disregard human/minority rights and get away without EU interference. On the other hand, the EU is aware of what happens when these countries lose their stability which, among other things, "keep migration in check". Brussels may push for regime pressure, but Italy, France, Spain, Greece, etc., which pay the first toll, need to remain pragmatic (Cameron, 2012). The EU has paid Turkey to keep millions of refugees in its territory for many years (DW, 2021).

The USA and China are the top trading partners of the EU, followed by the UK, Switzerland and Russia. Turkey and Japan come next (Figure 44).

Figure 44. EU imports and exports of goods with top trade partners. EUR Bn.



Source: (Eurostat, 2020)

According to the Pew Research Institute, the Europeans worry more about Russia than about the USA and China (the concern about those two is similar). Nevertheless, the Europeans are even more concerned about terrorism (including cyber), climate change and refuges from countries such as Iraq and Syria (Figure 45).

Figure 45. Major concerns by region

Regional medians saying ___ is a major threat to our country

	Europe	Asia-Pacific	Middle East	Africa	Latin America
	%	%	%	%	%
ISIS	**74**	**62**	*	54	40
Global climate change	64	61	44	**58**	**74**
Cyberattacks from other countries	54	52	40	53	54
The condition of the global economy	37	46	**59**	51	61
A large number of refugees leaving countries such as Iraq and Syria	41	35	48	55	31
The United States' power and influence	31	35	50	37	47
Russia's power and influence	41	29	35	31	23
China's power and influence	30	47	20	32	25

Source: (Pew, 2017)

The relationship with the USA is full of contradictions and has not been improving in the 21st century: "There was widespread distrust of the Bush Administration followed by initial enthusiasm and excitement at the election of the President Obama" (Cameron, 2012). Obama is perceived as having neglected Europe, and the Trump administration has alienated most of

the EU states, including Germany: “Trump’s abrasive foreign policy moves, often unveiled in all-caps tweets, have alienated not just Germany but much of Europe” (Euroactiv, 2020). The USA is Europe’s most important ally, so this relationship shapes the EU foreign relations without aspiring for subservience: the “European integration was inspired to a substantial extent by the desire to match the US and Soviet superpower, or at least to create a *third force* in international relations” (Smith & Steffenson, 2017). NATO has been a success, but the divergence of opinions about the Iraq invasion and the way in which the USA broke the EU ranks (with support from the UK, Spain and Portugal) created a chasm which persists. Moreover, the hopes for economic integration proved unfounded. The negotiations for a Transatlantic Trade and Investment Partnership (TTIP) began in 2013, but Trump called it off. In fact, Trump argued that the EU was one of the USA’s biggest foes (Contiguglia, 2018), and demanded much higher contributions to NATO’s budget. Moreover, Trump supported a no-deal Brexit and waved with a quick deal between the UK and the USA (Bayer, 2019). This thesis investigates the EU-USA relationship later. For now, it must be retained that the recent events make the life very hard for the Europeans defending an international positioning centered on the transatlantic relationships.

The relationship between the EU and the UK was always contentious and the UK played a role in the European inability to get its act together on foreign policy. The UK was the second EU economy and its largest military power. By losing the UK, the EU became smaller, weaker, and further away from the USA and China, with which the UK has preferential relations. The EU and the UK have not yet achieved an agreement in terms of trade policy (Pandzic, 2021), nor in terms of foreign and security relations (Whitman, 2020), so the future of the relation is unclear. The transatlantic relations will remain central to the EU foreign policy.

As mentioned, Russia respects strong armies and economic engagement. The EU, on the contrary, does not have an army and positions itself as a normative power, systematically using

economic sanctions in the promotion of its fundamental values. As such, despite being trade partners, the relationship has been tense in the last two decades. Moreover, for many member states which have forcefully been part of the USSR, Russia is their most important foreign relation, and they must engage pragmatically, not idealistically with it. Finland, for example, is not part of NATO and there is an important old IR concept called *Finlandization*, which means to remain neutral under the influence of the Soviet Union (Webster, 2021). The Ukraine invasion is an example of what can happen when the EU plays with eastern European countries vital for the territorial security of Russia – Russia pulls its military weight and ignores the EU's sanctions. Another important element in this relationship is the energy dependence on Russia: 30 percent of extra-EU's crude oil imports; 40 percent of natural gas; and 42 percent of solid fuel (mostly coal) imports originated from Russia (Eurostat, 2021).

The relationship between the EU and Japan has never lived to its full potential, and possibly never will. While sharing several interests in the global commons, the geographical distance and the fact that both are declining powers, tends to let the domestic and regional priorities of each side delay a relationship with significant economic and normative potential (Mayer, 2015). Finally, in terms of development policy, the EU is a strong supporter of the Millennium Development Goals, is the largest contributor to development and humanitarian assistance and is the largest market for goods from the developing countries. At the same time, it must deal with the colonial legacy of some member states and the protectionism of its agricultural policy (Cameron, 2012). In April 2021, a new agreement was signed with 79 African, Caribbean, and Pacific countries, which substitutes the former Cotonou agreement (2000) and engages with those countries in political, development and trade areas (EU_Council, 2021). The EU aids other countries in Latin America and Asia, but Africa has become a focus of the EU "given the enormity of the problems that the continent faces" (Cameron, 2012).

3.c. The EU-China relationship

3.c.i. The construction of the relationship since 1975

The formal extension of diplomatic relations between the EU (then EEC) and China dates back to 1975, three years after China's "startling rapprochement with the USA in 1972" (Brown, 2014). In 1985, it was signed the EU-China trade and economic agreement, focused on tariffs and market access and in 1988, the EC opened a delegation in Beijing. There was a first hiccup in the relationship in 1989, when the Tiananmen incidents led to the constitution of a European arms embargo to China, which persists. In 1990, the bilateral contacts resumed.

In the 1990s, "for the first time in fifty years, Sino-European relations are finally developing an independent dynamic of their own. Previously, the PRC's relations with Europe, and vice versa, were derivatives of the Cold War and broader relations with the superpowers" (Shambaugh, 1995). The EU played an important role in enabling the Chinese accession to the WTO in December 2001, and a comprehensive strategic partnership was signed in 2003,

> "when the EU and China formally established more than 50 sectorial dialogues covering the full spectrum of their bilateral relationship: trade and finance affairs, environment, education, culture and language training, customs cooperation, food, consumer and labour safety, agricultural, civil aviation, space cooperation, domestic regional policy, employment and social affairs, and civil society." (Brown, 2014).

At that time, "the EU came to the conclusion that China's rise was an enduring process, which would change the nature of the international system. Rather than object to the inevitable, the EU decided in favor of embracing the process, engaging China and influencing its strategic culture through dialogue and cooperation" (Crossick & Reuter, 2010). In its 2003 paper, China said that the "establishment of diplomatic relations between China and the EEC in 1975 has served the interests of both sides […] Despite their twists and turns […] China-EU relations now are better than any time in history" (PRC, 2003). For China, it is crucial that "there is no fundamental conflict of interest between China and the EU and neither side poses a threat to the

other" (PRC, 2003). More concretely, "the EU does not seek hegemony around the world […(and)] EU countries do not have substantial geopolitical and strategic interests in the Asia Pacific region" (Wang & Song, 2016). On the EU side, "economic and trade interests have played a pivotal role [… (but)] the EU has also desired and attempted to transform China, helping China to understand and observe international norms, improving the rule of law in China, and encouraging the Chinese government to respect HR and political pluralism" (Li M. , 2016). The EU became more normative after the *honeymoon phase* of 1995-2004:

> "Merkel raised HR as one of key priorities in Sino-German relations in 2007, before meeting the Dalai Lama. And Chinese threats of retaliation were clearly unheeded when the European Parliament presented the Sakharov Prize to Hu Jia – a sociopolitical activist in China – in 2008. China responded by cancelling the planned China-EU summit." (Jorgensen & Wong, 2016).

Both the EU and China had radically changed in the previous decade: the EU grew from 12 to 27 member states, and the Chinese economy grew exponentially. In 2006, the EU issued a new communication called *Closer Partners, Growing Responsibilities*, which identified China as "the single most important challenge for EU trade policy", since the EU became the largest export market to China, and China the largest import market to the EU. The EU alerted that if China did not open further, the resulting imbalance would create resistance to China:

> "There is a growing risk that the EU-China trading relationship will not be seen as genuinely reciprocal. Political pressure in the EU to resist further openness to Chinese competition is likely to increase if these problems are not addressed" (COM, 2006).

The EU was requesting symmetry, but also other political and sustainability reforms. The 2006 Communication had five main initiatives with clear objectives:

- Support the transition to an open/plural society (rule of law, human/minority rights, etc.);
- Promote sustainable development (clean/safe energy, environment, climate change, etc.);
- Improve trade/economic relations (market access, WTO rules, level playing-field, etc.);
- Strengthen bilateral cooperation (scientific and technological cooperation, Chinese migration, cultural interchange, more effective bilateral structures);

- Foster international and regional co-operation (shared interests in multilateralism, arms non-proliferation, peace and security, etc.).

The High-Level Economic and Trade Dialogue and the High-Level Strategic Dialogue were established in 2008 and 2010, respectively. Trade volumes tripled in the 2010s, but also the EU trade deficit with China tripled to EUR 133 Bn in 2009. This figure hides that >50 percent of the Chinese exports are produced by EU companies (Gonçalves, 2011).

China used the financial crisis confusion to affirm itself in the world, including throughout Eurasia. While the relationship with the USA went sour ever since, the engagement with the EU deepened at first. The EU, for which the financial crisis turned into a sovereign debt crisis of life-threatening proportions, saw a lifeline in the Chinese wallet.

The China-EU relationship of the last decade is marked by the COFDI in the EU, which rose significantly until it peaked in 2016-17. Its rise and fall is the subject of Chapter 4. What is important to understand at this point is that the EU did not get its act together in dealing with the Chinese capital. On the contrary, the EU member states competed among each other for it. The difference in sub-regional interests became obvious: the richer central/ northern countries, like Germany, wanted easier access to the Chinese market, whereas the southern economies, like Portugal, craved for COFDI and were less interested in market access, since their companies are not competitive there. Moreover, the northerners would rather avoid Chinese competition in bidding for the southern bargains forcefully for sale:

> "northern Europeans want policies focused on their own access to the China market. Eastern Europeans look to Chinese investment in order to supplement falling EU subsidies in the near future. Southern Europeans have already received significant Chinese investment, and, like eastern Europeans, they increase their economic options by welcoming new entrants. These peripheries are not united and so any coalitions between them risk becoming excessively complex." (Godement & Vasselier, 2017).

Beijing realized that there were much bigger and technologically advanced companies in the center, but in the periphery the value for money was better and reciprocity is not demanded.

Additionally, several EU governments actively touted for COFDI waving with *friendship* in return. Many complain about China's *divide-and-conquer* strategy in the EU, but the author believes that such vision does not get to the heart of the Chinese modus operandi. China's tactic is casting a wide net and watching which fishes try harder to be caught:

> "China often hardly needs to make any effort when it comes to engaging with the rich and powerful of Europe. Politicians, business intermediaries, and government officials, or even local officials who have no inkling about its negotiating style, are more than willing to make overtures towards China […] To cite a Chinese proverb, flowing water will always find a canal." (Godement & Vasselier, 2017).

China secures goodwill among several EU governments, which then serves as a divisive factor, used selectively in the matters closer to China's heart, generally without needing to ask for it:

> "the comment is often heard that Chinese diplomats do not dictate, but that their interlocutors know well what to say – and what not to say. They know that mentions of Taiwan, Tibet, HR, and now the South China Sea can trigger a diplomatic crisis. A smoking gun of a Chinese diktat is seldom found, because it need not exist." (Godement & Vasselier, 2017).

In 2013, the EU and China launched the *EU-China 2020 Strategic Agenda for Cooperation*, an ambitious goal-setting joint document, which pledged for cooperation, putting peace and security as the core of the relationship. A 2015 joint declaration on 5G networks followed suite. Ten years after the 2006 COM, the EU published a new EU strategy on China, with clearly defined goals (Figure 46), along the same rhetoric: more engagement, pushing for an investment agreement with reciprocity and a level playing field, and maintaining high expectations on the public goods, rule of law and HR. In 2018, the EU issued a document about sustainable, comprehensive and international rules-based connectivity called *Connecting Europe and Asia – Building blocks of an EU strategy.* Its main goals are to foster Eurasian cooperation in transport, energy and digital networks, as well as education, R&D, culture, sports and tourism.

Figure 46. Objectives of the 2016 new EU strategy on China

- Seize new openings to strengthen its relations with China.
- Engage China in its reform process in practical ways which result in mutual benefits for our relations in economic, trade and investment, social, environmental and other areas.
- Promote reciprocity, a level playing field and fair competition across all areas of co-operation.
- Push for the timely completion of negotiations on a Comprehensive Agreement on Investment and an ambitious approach to opening up new market opportunities.
- Drive forward infrastructure, trading, digital and people-to-people connectivity between Europe and China based on an open rules-based platform with benefits for all the countries along the proposed routes.
- Promote global public goods, sustainable development and international security in line with our respective UN and G20 responsibilities.
- Promote respect for the rule of law and human rights within China and internationally.
- Maximise EU cohesion and effectiveness in its dealings with China.

Source: (EC, 2016)

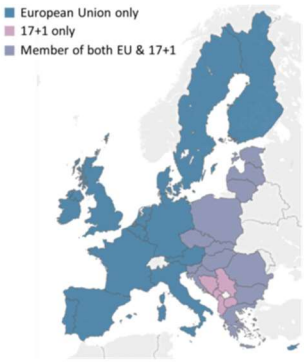
In 2019, the High-Representative issued a communication, raising the tone and demanding more assertiveness. It highlights that the EU and China are not always partners, sometimes being systemic rivals, and demands unity and the usage of linkages to gain leverage over China:

> "China is, simultaneously […] a cooperation partner […], a negotiating partner,]…] an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance. This requires a flexible and pragmatic whole-of-EU approach enabling a principled defence of interests and values. […] The EU should use linkages across different policy areas and sectors in order to exert more leverage in pursuit of its objectives […] Neither the EU nor any of its Member States can effectively achieve their aims with China without full unity. In cooperating with China, all Member States, individually and within sub-regional cooperation frameworks, such as the 16+1 format, have a responsibility to ensure consistency with EU law, rules and policies." (EC, 2019).

It reflected a "growing impatience in EU circles with China's failure to open its markets to European companies in key sectors". And it has borne fruit since its timing and language "helped give the EU concrete leverage when dealing with China during a crucial stage, while avoiding having to resort to confrontation or containment" (Brattberg & Corre, 2019).

The communication refers to the 17+1 framework (former 16+1, plus Greece), created in 2012 to foster the business and investment cooperation with 17 Central and Eastern European (CEE) countries (Figure 47). It never grew much beyond a bi-annual conference (in Beijing plus in a European capital). Brussels first saw it as a divisive tactic, but the concerns seem to have been overrated: the "mechanism has transformed into a zombie mechanism" (Brînză, 2021).

Figure 47. 17 European members of the 17+1



- Albania
- Bosnia and Herzegovina
- Bulgaria
- Croatia, Czech Republic
- Estonia
- Greece
- Hungary
- Latvia
- Lithuania
- Northern Macedonia
- Montenegro
- Poland
- Romania
- Serbia
- Slovakia
- Slovenia

Source: (ECA, 2020)

The three key EU-China documents mentioned above include 74 actions which can be grouped in 10 categories to find the relative European priorities in this relation (Figure 48).

Figure 48. EU actions towards China by thematic categories

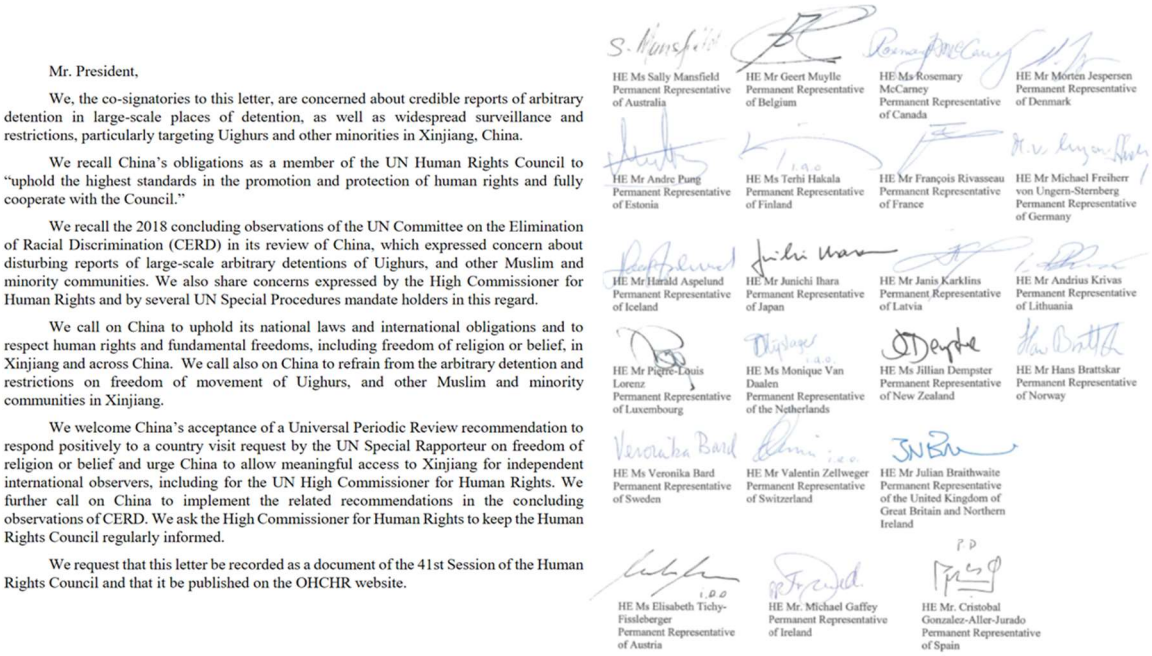
Categories	Number of actions
A) Promoting EU values along with the three United Nations (UN) pillars (human rights, peace and security, development)	7
B) Preserving EU unity	5
C) Reciprocity to balance the relationship and level playing field	17
D) Preventing distortive effects on the EU internal market	2
E) Sustainable Economic Development and Good Governance	16
F) Tackling climate change and protecting the environment	4
G) Global public health concerns	1
H) Deepening the engagement on peace and security	10
I) Fostering cross-cultural understanding and cooperation on innovation	4
J) Wider foreign policy approach	8

Source: (ECA, 2020)

Also in 2019, 15 EU countries joined Australia, Iceland, Japan, Switzerland, Canada, New Zealand (NZ) and Norway in signing a letter to the President of the HR Council (Figure 49). The letter recalls China's obligations as a member of the UN HR Council and requests China "to uphold its national laws and international obligations and to respect HR and fundamental

freedoms of religion or belief in Xinjiang and across Europe". This also means that 13 EU countries refused to sign such letter (Bulgaria, Croatia, Cyprus, Czech Republic, Greece, Hungary, Italy, Malta, Poland, Portugal, Romania, Slovakia, Slovenia).

Figure 49. Word and signatories of the 2019 letter to the HR Council



Mr. President,

We, the co-signatories to this letter, are concerned about credible reports of arbitrary detention in large-scale places of detention, as well as widespread surveillance and restrictions, particularly targeting Uighurs and other minorities in Xinjiang, China.

We recall China's obligations as a member of the UN Human Rights Council to "uphold the highest standards in the promotion and protection of human rights and fully cooperate with the Council."

We recall the 2018 concluding observations of the UN Committee on the Elimination of Racial Discrimination (CERD) in its review of China, which expressed concern about disturbing reports of large-scale arbitrary detentions of Uighurs, and other Muslim and minority communities. We also share concerns expressed by the High Commissioner for Human Rights and by several UN Special Procedures mandate holders in this regard.

We call on China to uphold its national laws and international obligations and to respect human rights and fundamental freedoms, including freedom of religion or belief, in Xinjiang and across China. We call also on China to refrain from the arbitrary detention and restrictions on freedom of movement of Uighurs, and other Muslim and minority communities in Xinjiang.

We welcome China's acceptance of a Universal Periodic Review recommendation to respond positively to a country visit request by the UN Special Rapporteur on freedom of religion or belief and urge China to allow meaningful access to Xinjiang for independent international observers, including for the UN High Commissioner for Human Rights. We further call on China to implement the related recommendations in the concluding observations of CERD. We ask the High Commissioner for Human Rights to keep the Human Rights Council regularly informed.

We request that this letter be recorded as a document of the 41st Session of the Human Rights Council and that it be published on the OHCHR website.

HE Ms Sally Mansfield, Permanent Representative of Australia
HE Mr Geert Muylle, Permanent Representative of Belgium
HE Ms Rosemary McCarney, Permanent Representative of Canada
HE Mr Morten Jespersen, Permanent Representative of Denmark
HE Mr Andre Pung, Permanent Representative of Estonia
HE Ms Terhi Hakala, Permanent Representative of Finland
HE Mr François Rivasseau, Permanent Representative of France
HE Mr Michael Freiherr von Ungern-Sternberg, Permanent Representative of Germany
HE Mr Harald Aspelund, Permanent Representative of Iceland
HE Mr Junichi Ihara, Permanent Representative of Japan
HE Mr Janis Karklins, Permanent Representative of Latvia
HE Mr Andrius Krivas, Permanent Representative of Lithuania
HE Mr Pierre-Louis Lorenz, Permanent Representative of Luxembourg
HE Ms Monique Van Daalen, Permanent Representative of the Netherlands
HE Ms Jillian Dempster, Permanent Representative of New Zealand
HE Mr Hans Brattskar, Permanent Representative of Norway
HE Ms Veronika Bard, Permanent Representative of Sweden
HE Mr Valentin Zellweger, Permanent Representative of Switzerland
HE Mr Julian Braithwaite, Permanent Representative of the United Kingdom of Great Britain and Northern Ireland
HE Ms Elisabeth Tichy-Fisslberger, Permanent Representative of Austria
HE Mr. Michael Gaffey, Permanent Representative of Ireland
HE Mr. Cristobal Gonzalez-Aller-Jurado, Permanent Representative of Spain

Source: (UN, 2019)

It is obvious that "the EU and China have divergent views on democracy. However, it is important to remember that many countries in Europe are only very recent democracies". Additionally, "China does not oppose the EU concept of democracy; what Chinese elites insist is that EU models of democracy do not fit China's current situation […] economic rights have priority over HR, and economic and social freedom have priority over political and civil freedom/rights" (Crossick & Reuter, 2010).

What happened in 2020 illustrates the status of the relationship. Germany presided over the EU council in the second semester of 2020, almost at the end of the Merkel Era: Merkel was Chancellor of Germany since 2005, and for many people the *de facto* leader of the EU (Forbes, 2021). In the last week of 2020, the EU and China signed the agreement in principle of the CAI, on what was perceived as too strong a push by Germany:

> "Merkel's strong push to conclude the EU-China deal in the last days of the year has left a bad aftertaste among a group of EU countries who said they felt ignored. Officials from Italy, Poland, Belgium and Spain criticized the way. Germany pushed through the investment agreement with China in the final days of the German presidency of the Council of the EU, despite their warnings that the timing was tone deaf to slave labor concerns in China and risked alienating incoming U.S. President Joe Biden. The officials said they felt steamrolled by Merkel and the 'German engine' inside the EC, in particular Commission President Ursula von der Leyen and trade department director Sabine Weyand, who are both German." (Vela, Leali, & Moens, 2021).

Germany is the main winner from the CAI, getting broader access in its top exports market. It pushed the deal in the *last minute*, without support from its peers, sidelining the HR concerns, and despite opposition from the new USA administration, which was caught off guard. This was perceived as Germany moving ahead with China and leaving its peers behind, but because German politics are at a crossroad, the implications remain unclear (Pongratz, 2021).

Some scholars discuss which schools best explain this relationship: (1) *institutionalism*, for whom preferences are shaped by the institutional structures that create a series of rituals and regulations for individuals to abide by; (2) *social theories*, for whom institutions are shown to be embedded in a cultural nexus that is undergoing constant negotiation and renegotiation; or (3) *agency/stakeholder* approaches, for whom individuals are the main determinants of their behavior patterns (Wyzycka & Hasmath, 2016). The reality shows that all such views have explanatory power, but none is sufficient standalone. Realist evaluations tend to see the EU-China relation marked by the pursuit of increased trade and investment and presented as status-seeking by both parties. Alternatively, some constructivists argue that the relationship has been evolving intersubjectively, "in tandem with the growth and changing nature of each actor" (Jorgensen & Wong, 2016). It seems that "rationality and economic explanations cannot account for the *honeymoon phase* of 1995-2004 unexpectedly turning sour by 2007-2008. This shift might be partially attributed to normative concerns that constituted the EU's and China's respective identities, relative to each other".

The EU became more geopolitical and less idealist as it lost hope for Chinese political reform. That does not mean that the EU seconds every American geopolitical interest. It may be in its interest to grow as a third geopolitical pole, and from an economic perspective, China remains its best hope for growth. Moreover, China is a necessary party in multiple global challenges.

The EU respects China's territorial sovereignty: "The EU always stresses its commitment to the *One China* policy, but strongly opposes forceful ways of achieving unification" (Crossick & Reuter, 2010). Unlike the USA, "China does not view the EU as a threat to achieving its eventual goal of unification with Taiwan" (Cameron, 2012). At the same time, the EU worries that the Chinese foreign policy is enabling autocratic governments to prosper. China invests

> "in some energy-rich *states of concern* [...] whilst ignoring the nature of political leadership there. Refraining from interfering in other state's internal affairs is a long-standing cornerstone of China's foreign Policy, but in this case it directly undermines whatever leverage the EU could have in promoting reforms" (Crossick & Reuter, 2010)

The arms embargo and the refusal to grant it MES have long annoyed China (Cameron, 2012). From the EU side, besides the growing trade deficit and the "impasse surrounding the issue of tariffs against Chinese steel *dumping*" (Hosli, Campioni-Noack, Johnson, & Wu, 2020), there are other economic grievances such as frequent infringement of copyrights, trademarks, and a lack of transparency in Chinese trade and administrative regulations (Cameron, 2012).

More importantly, we must remember that the CCP's #1 priority is to remain in power, and #2 priority is unity – proselytism about liberal democracy or support for secession is disgruntling.

The EU seems to overrate its importance to China. In the 2000s, China took the EU seriously, as a potential pole, in a multipolar world. More recently, it treats the EU with something close to contempt (Ash, 2012). China has understood that the lack of internal unity and homogeneity in the EU demands (also) to maintain active bilateral channels (Figure 50).

The normative considerations remain stronger in rhetoric than in practice, partially because the Chinese engagement in the EU already secures sufficient goodwill to avoid a cohesive stance.

Figure 50. Member states' relationship with China

Strong relation
Medium relation
Weak relation

	Politics and diplomacy	Economy and trade	Influence
Cyprus	Friendly and supportive; no concerns about HR or Seas disputes	Reciprocity not a priority, welcomes investment and trade	Allows for golden citizenship in 3 months; 1 Confucius Institute (CI)
Bulgaria	Positive engagement; no concerns about HR or Seas disputes	Reciprocity not a priority, welcomes investment and tech cooperation	Overall perception is improving and there are 2 CIs
Greece	Close relationship, often blocking harsher EU stances vis a vis China	Reciprocity not a priority, welcomes COFDI and opposes EU screening	Influence through media and political lobbying; 1 CI
Malta	Positive engagement; no concerns about HR or Seas disputes	Reciprocity not a priority, welcomes investment and tech cooperation	Influence through media and political lobbying; 1 CI
Portugal	Comprehensive engagement; no concerns about HR or Seas disputes	Welcomes COFDI, does not support EU in harsh stance with China	Influence through business ownership, media and political lobbying; 4 CIs
Hungary	Close relationship, often blocking harsher EU stances vis a vis China	Needs to second Germany on trade, but welcomes COFDI	Realist/Geopolitical relationship; Hosts several Chinese Org. and 4 CIs
Austria	Positive about the BRI, did not sign HR letter but received Dalai Lama	Reciprocity not a priority, welcomes investment and tech cooperation	Is a centre for Chinese media, PR and other NGOs; 2 CIs
Croatia	Positive about the BRI and 16+1; no concerns about HR or Seas disputes	Aligns with the EU on trade but welcomes COFDI	Hosts HQ of Chinese Southeast Europe Business Association and 1 CI
Slovenia	Supports EU China policies, remains low profile on HR but met Dalai Lama	Actively touting tech cooperation and COFDI in infrastructure	Slovenia-China friendship groups are widespread; Hosts 1 CI
Luxembourg	Supports the EU positions on China but remains low profile	Very open country overall; Important financial centre for China in the EU	Limited barriers for gaining access to decision-makers; Hosts 1 CI
Romania	Supports the EU positions on China but remains low profile on HR	Actively touts for COFDI but supports reciprocity demands	Cultural collaboration and 4 CIs, but there is media pressure on Chinese ties
Slovakia	Remains low profile on HR, but met Dalai Lama	Supports EU policies on trade and hosts and steers significant COFDI	Hosts 2 CIs and public opinion is improving significantly
Finland	Has seconded HR concerns in the past but is increasingly pragmatic	Strong trade and FDI flows on a bidirectional basis	Hosts one CI but the history of cyber espionage remains a topic of concern
Netherlands	Has seconded HR concerns and met the Dalai Lama	Low profile approach, less worried about trade than sensitive COFDI	Hosts 2 CIs and intelligence community worries about espionage
Poland	Accelerating cooperation, no concerns on HR but met Dalai Lama	Reciprocity is mentioned, welcomes COFDI if steered and screened	Hosts 5 CIs and public opinion is improving significantly
Ireland	Positive political engagement but civil pressure keeps it in check	Aligns with the EU on trade and wants reciprocity but welcomes COFDI	Hosts 2 CIs but public and media remain sceptical
Italy	Close cooperation, low profile on HR but hosts Dalai Lama	Aligns with the EU on trade but champions COFDI	Hosts 12 CIs but public and media remain sceptical
Latvia	Close cooperation, low profile on HR but hosts Dalai Lama	Aligns with the EU on trade but welcomes COFDI and tech cooperation	China is less of an issue in Latvia, but public remains sceptical; Hosts 1 CI
France	Mild voicing of HR concerns, some military support to non-China Asia	Reciprocity is a priority, and COFDI is large but duly screened	Significant lobbying, 17 CIs and multiple subnational agreements
Lithuania	Avoids bilateral politics and aligns with EU; Hosted the Dalai Lama	Aligns with the EU on trade; low COFDI worrying resell to Russia	Limited influence, 1 CI and multiple Tibet manifestations
Spain	Used to keep low profile on HR, but Tibet pressure got out of hand	Large trade deficit increased demands for reciprocity; COFDI is important	Limited influence, 1 CI and worsening public perception
Sweden	Strong stance about HR and South China Seas	Aligns with EU on trade and hosts limited COFDI, despite stake in Volvo	Limited influence, 1 CI and worsening public perception
Estonia	Hosted Dalai Lama and seconds HR concerns	Reciprocity not a priority, welcomes investment and tech cooperation	Estonia is a target for influence, with intermediate success and hosts 1 CI
Czech Republic	Hosted Dalai Lama some times and seconds HR concerns	Aligns with the EU on trade but welcomes COFDI across all sectors	It is visibly penetrated by China, but questionable influence success; 1 CI
Denmark	Hosted Dalai Lama some times and seconds HR concerns	China is a trade partner and accepts COFDI; Huawei invested in TDC	China is a polarizing topic; hosts 3 CIs and 8 Confucius classrooms
Germany	Pressures regarding Tibet, South Sea and HR; wants EU coordination	Massive interdependence; increasing tension to get reciprocity concessions	Limited foothold on the media and 19 CIs; Too large for such tactics
Belgium	Open pressures regarding Taiwan, Tibet and HR	Reciprocity is mentioned bilaterally; Defensive about COFDI	Hard to distinguish EU from Belgium; Many lobbying efforts and 6 CIs

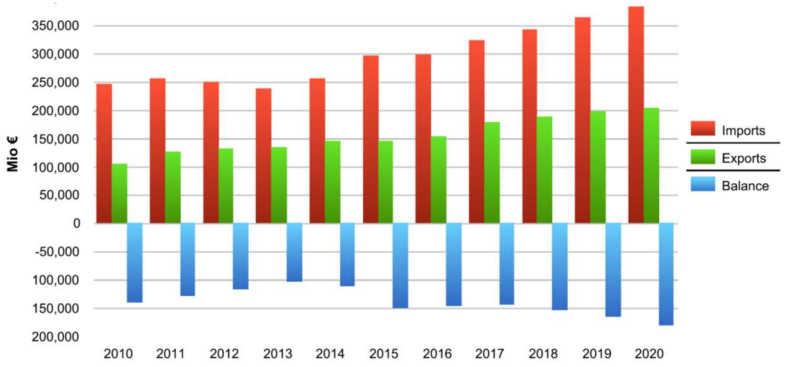
Source: By the author, based on (Godement & Vasselier, 2017)

Complexity is what "a mature, normal relationship is about […] dichotomizing (partner vs. competitor; ally vs. rival; winner vs. loser) is simply unhelpful" (Breslin, 2010).

In China, the importance of Europe is not perceived in a consistent way. Nevertheless, Europe has always been valued as a major economic partner for bilateral trade, and a source of technology and investment (Wang & Song, 2016). The same can be said from the EU side, where it is common knowledge that China is an important trade partner, but with different degrees in each member state, and clear winners and losers.

The Directorate-General for Trade of the EC provides updated figures on the EU-China trade. The EU's trade deficit has remained high in the last 5 years (Figure 51).

Figure 51. EU trade flows of goods and balance with China



Source: (EC, 2021)

Imports grow 6 percent and exports 7 percent per year, except for 2020, when the growth was 2 percent. As such, in 2020, the EU was China's #2 exports market (after the USA) and #1 imports market, followed by Taiwan, Japan and South Korea (Figure 52).

Figure 52. China's top trading partners

	Imports				Exports				Total trade			
	Partner	Value Mio €	% World		Partner	Value Mio €	% World		Partner	Value Mio €	% World
	World	1,803,763	100.0		World	2,274,579	100.0		World	4,078,342	100.0
1	EU27	227,019	12.6	1	USA	396,456	17.4	1	EU27	570,919	14.0
2	Taiwan	176,900	9.8	2	EU27	343,900	15.1	2	USA	515,632	12.6
3	Japan	154,167	8.5	3	Hong Kong	241,169	10.6	3	Japan	279,120	6.8
4	South Korea	151,901	8.4	4	Japan	124,954	5.5	4	South Korea	250,858	6.2
5	USA	119,176	6.6	5	Vietnam	99,945	4.4	5	Hong Kong	247,408	6.1
6	Australia	100,479	5.6	6	South Korea	98,957	4.4	6	Taiwan	229,571	5.6
7	Brazil	73,561	4.1	7	United Kingdom	63,620	2.8	7	Vietnam	168,973	4.1
8	Vietnam	69,028	3.8	8	India	58,466	2.6	8	Australia	147,326	3.6
9	Malaysia	65,440	3.6	9	Taiwan	52,671	2.3	9	Malaysia	115,283	2.8
10	Russia	49,984	2.8	10	Singapore	50,798	2.2	10	Brazil	104,179	2.6
1	EU27	227,019	12.6	2	EU27	343,900	15.1	1	EU27	570,919	14.0

Source: (EC, 2021)

For the EU, China is the #1 imports market and the #3 exports market (Figure 53).

Figure 53. EU's top trading partners

	Imports			Exports			Total trade		
	Partner	Value Mio €	% Extra-EU	Partner	Value Mio €	% Extra-EU	Partner	Value Mio €	% Extra-EU
	World	1,713,840	100.0	World	1,932,237	100.0	World	3,646,078	100.0
1	China	383,888	22.4	1 USA	353,353	18.3	1 China	586,737	16.1
2	USA	202,877	11.8	2 United Kingdom	277,728	14.4	2 USA	556,230	15.3
3	United Kingdom	167,238	9.8	3 China	202,849	10.5	3 United Kingdom	444,966	12.2
4	Switzerland	108,599	6.3	4 Switzerland	142,368	7.4	4 Switzerland	250,967	6.9
5	Russia	95,037	5.5	5 Russia	78,977	4.1	5 Russia	174,014	4.8
6	Turkey	62,466	3.6	6 Turkey	69,887	3.6	6 Turkey	132,353	3.6
7	Japan	54,934	3.2	7 Japan	55,119	2.9	7 Japan	110,053	3.0
8	South Korea	44,105	2.6	8 Norway	48,604	2.5	8 Norway	90,673	2.5
9	Norway	42,069	2.5	9 South Korea	45,291	2.3	9 South Korea	89,397	2.5
10	Vietnam	34,420	2.0	10 Canada	33,460	1.7	10 India	65,191	1.8
1	China	383,888	22.4	3 China	202,849	10.5	1 China	586,737	16.1

Source: (EC, 2021)

Overall, China is EU's largest trading partner representing 16 percent of its trade, and the EU is China's largest trading partner (14 percent). The USA is the #2 partner to both, and the #1 importer from China and the EU.

Manufactured goods account for 97 percent of the flows from China to the EU, but only 84 percent in the other direction (Figure 54). Half of the EU imports are machinery and appliances, whereas that category accounts for one third of EU's exports to China.

Figure 54. EU-China trade breakdown

Imports 2020			Exports 2020		
SITC product Groups					
Product	Value Mio €	% Total	Product	Value Mio €	% Total
Primary products	10,239	2.7	Primary products	30,491	15.0
Manufactures	371,926	96.9	Manufactures	169,452	83.5
Other products	900	0.2	Other products	483	0.2
Other	823	0.2	Other	2,423	1.2
Top 5 - HS sections					
Product	Value Mio €	% Total	Product	Value Mio €	% Total
XVI Machinery and appliances	195,106	50.8	XVI Machinery and appliances	68,034	33.5
XI Textiles and textile articles	48,445	12.6	XVII Transport equipment	36,510	18.0
XX Miscellaneous manufactured articles	27,991	7.3	VI Products of the chemical or allied industries	25,421	12.5
XV Base metals and articles thereof	20,462	5.3	XVIII Optical and photographic instruments, etc.	14,277	7.0
VI Products of the chemical or allied industries	19,410	5.1	XV Base metals and articles thereof	10,810	5.3
Top 5 - SITC sections					
Product	Value Mio €	% Total	Product	Value Mio €	% Total
7 Machinery and transport equipment	207,928	54.2	7 Machinery and transport equipment	105,512	52.0
8 Miscellaneous manufactured articles	86,886	22.6	5 Chemicals and related prod, n.e.s.	30,148	14.9
6 Manufactured goods classified chiefly by material	58,561	15.3	8 Miscellaneous manufactured articles	21,148	10.4
5 Chemicals and related prod, n.e.s.	21,050	5.5	6 Manufactured goods classified chiefly by material	16,684	8.2
0 Food and live animals	4,432	1.2	0 Food and live animals	14,456	7.1

Source: (EC, 2021)

Bilaterally, only Germany, Ireland and Finland have trade surplus with China (Figure 55). The remaining countries have trade deficits, and half of the deficit is concentrated in the Netherlands, which has long fulfilled "the distributional role of gateway to the European hinterland for China" (Butter & Hayat, 2011).

Figure 55. EU Member State trade balance of goods with China, 2020

EU trade balance of goods with China, 2020							
(€ million)	Balance	Imports	Exports	(€ million)	Balance	Imports	Exports
Germany	14 388	82 039	96 426	Denmark	-1 134	6 723	5 590
Ireland	6 025	3 836	9 861	Slovenia	-1 698	2 150	452
Finland	571	2 496	3 068	Austria	-1 720	5 739	4 019
Luxembourg	-76	276	200	Portugal	-2 500	3 067	568
Malta	-322	363	41	Greece	-2 888	3 743	855
Cyprus	-358	445	87	Romania	-4 413	5 059	646
Latvia	-477	637	160	Hungary	-7 344	8 862	1 518
Estonia	-502	747	245	Belgium	-9 621	18 162	8 541
Bulgaria	-601	1 520	919	Czechia	-14 557	16 817	2 260
Sweden	-637	8 095	7 458	Spain	-16 974	25 141	8 167
Slovakia	-731	2 770	2 040	France	-18 500	35 993	17 493
Lithuania	-863	1 179	316	Italy	-19 257	32 144	12 887
Croatia	-993	1 079	86	Poland	-20 268	23 242	2 974
				Netherlands	-75 379	91 071	15 692

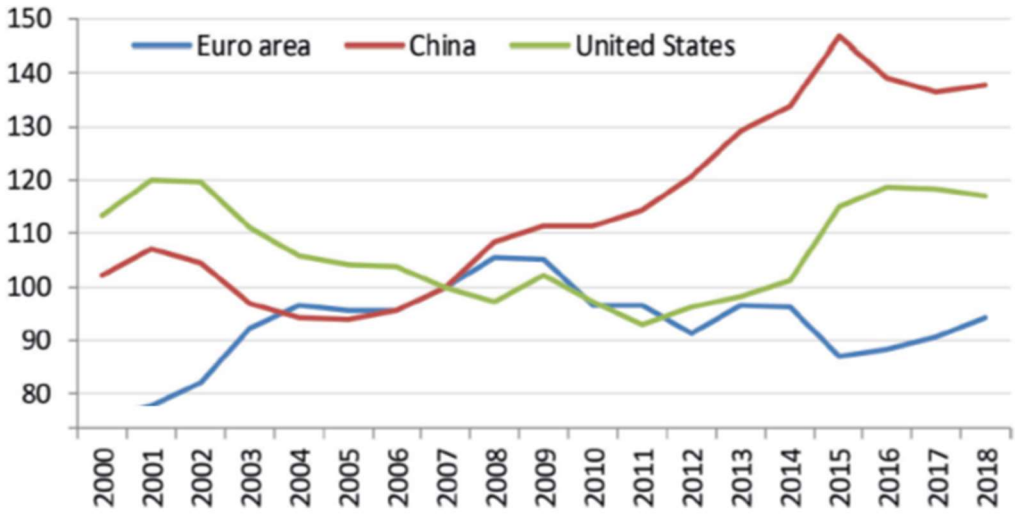
Source: (Eurostat, 2021)

Contrary to the mainstream belief in the 2000s, the European population and its political leaders no longer adhere to the free-market fundamentalism advocated by the economists' community. Even if some populist leaders overplay the argument, the truth is that "globalization has not lifted all boats. Many working families have been devastated by the impact of low-cost imports from China, Mexico and elsewhere. And the big winners have been the financiers and skilled professionals who taken advantage of expanded markets" (Rodrik, 2018). The EU is a striking example of that. The EU integration was simultaneously too fast economically and too slow politically. The EU tried and failed the impossible trilemma of having "*hyperglobalization*, democracy and national sovereignty all at once" (Rodrik, 2018). To make things worse, when the crisis came, "Germans and other creditor nations have clung far too long to the notion that the answer lies in what's known as structural reform", an old recipe under the *Washington consensus* umbrella, which yielded questionable economic results and severe, sometimes

unbearable, political burden (Rodrik, 2018). Since the launch of the EUR project (2001), Italy did not experience a single year of GDP growth above 2 percent until 2020, and Portugal witnessed only one until 2016. It is difficult to argue that these countries benefited economically from the openness that resulted from the single currency and China's accession to the WTO. On its end, China was masterful in exploiting the benefits of globalization, keeping domestic protections for as long as possible. China was smarter. Was it fair? Such normative debate does not fit the scope of this thesis.

On the monetary side, China has been appreciating its currency against the EUR and the USD since 2005 (Figure 56). Put simply, this implies a reduction of the trade surplus "contributing to higher real income and consumption and by reorienting the economy towards non-traded or less-traded sectors, such as services and construction, while slowing the growth of manufacturing" (Dadush, Jiménez, & Gao, 2019).

Figure 56. Real effective exchange rate EUR, RMB, USD



Source: (Dadush, Jiménez, & Gao, 2019)

3.c.ii. China-EU relations and the USA

The EU is becoming a more modest player, focused on a *principled pragmatism*, i.e., to "partner selectively with players whose cooperation is necessary to deliver global public goods and address common challenges" (EU, 2016). As seen, the EU as a whole is a world-scale yet declining economic power, but an incompetent military power. China is a rising economic and military power that was allowed growth space until its current sheer size and affirmative stance resulted in a defensive reaction from the USA, and in an ambivalent European reaction.

The USA is the most powerful nation in the history of the world, with a military and economic power of unmatched proportion, but increasingly fearful of China and disengaged from the Western European peers. Many argue that the USA dropped its hegemonic positioning and its willingness to play the role of policeman of the world, and even less so to pay that bill on its own. The US Congress has been issuing annual reports about the military and security developments involving China for 20 years. The most recent report explains that China is successfully progressing towards complete military modernization by 2035 and achieving a world class military by 2049. While in 2000 China focused on waging large-scale land warfare along its borders and was endowed with largely obsolete tools, in 2020 China is already better than the USA in several military dimensions (DOD, 2020). China has the largest navy in the world and the largest shipbuilding capacity. It has the largest standing ground force in the world and the largest arsenal of land-based conventional ballistic and cruise missiles. It also has a top-notch air defence system (DOD, 2020). According to the American conviction, the CCP thinks economic development is the central task driving China's modernization, including the military, and there is a proactive Civilian-Military Fusion plan which aims at leveraging civilian (technological and industrial) capabilities in pursuit of a self-reliant defence industry (DOD, 2020). The Chinese economic growth is seen as an enabler of larger defence budgets, but the BRI and the *Made in China 2025* initiatives are also instrumental in fostering the Chinese

industrial and technological clout. While China has historically focused on active defence and regional threats (e.g., a Taiwan contingency), it is actively expanding other capabilities which can play an active role in advancing foreign policy in more distant regions (DOD, 2020).

Obama attempted a rapprochement with China while thinking that China needed to be rebalanced. China was recognized as a strategic partner and a joint statement was signed in November 2009: "The two sides agreed that respecting each other's core interests is extremely important to ensure steady progress in US-China relations" (USA&PRC, 2009). At the same time, Obama announced the *pivot to Asia*, which was neither well received by the EU nor by China. The pivot meant to bolster "bilateral security alliances with Japan, South Korea, and the Philippines", which "intensified the strategic distrust in the relationship" (Can & Soto, 2020). Obama's foreign policy "paired an attempt to *lead from behind* on security issues with a *globalist approach* relying on multilateralism on economic and other issues such as climate change" (Men, Schunz, & Freeman, 2020).

With the arrival of President Trump, "the US then moved towards a perception of multipolarity as a primarily competitive scenario. The Trump administration's 2017 National Security Strategy translates the President's *America First* agenda into a foreign policy guided by *principled realism*, which combines sovereignty concerns and hard power display with opposition to multilateralism" (Men, Schunz, & Freeman, 2020). Trump denounced China as a rival undermining the American interests. The Biden administration disagrees on many things, such as the opposition to multilateralism, but the China strategy did not change substantially. Even before Obama, "in 2005, the EU proposal to lift its arms embargo against China was abandoned to a large degree due to the pressure from the US" (Men, Schunz, & Freeman, 2020). The USA and the EU are closely interlinked: both adhere to basic free-market principles and their economic interactions largely occur within common rules and a shared sense of fairness (even if Trump disagreed). In fact, "both the EU and the US economies are often seen as a unit,

falling under the category of *the West* and the EU-US trading relationship remains one of the defining features of the global economy". Beyond economics, "the Western European states that continue to exert stronger influence over the EU share more of a common political, social and economic historical trajectory and philosophical outlook with the US than with China" and "a large proportion of EU member states are also members of NATO which […] is by far the most pre-eminent intergovernmental military alliance today" (Hosli, Campioni-Noack, Johnson, & Wu, 2020). The Iraq intervention raised EU's skepticism about the reliability of the USA as a security partner and the Obama administration deprioritized the Atlantic in many ways. More important were the developments under Trump, which include pulling the USA out of the Paris climate agreement, the Iran nuclear deal, the UN HR Council, and "to openly question the integrity of the EU by speaking in support of Brexit. Furthermore, his blunt and direct stance with regard to financial pledges to NATO has led to disillusionment among its Western European members" (Hosli, Campioni-Noack, Johnson, & Wu, 2020).

In strategic terms, thinking about the triangle USA-China-EU is a misconception. There is a USA-China-Russia triangle, and the EU needs to be understood in relation to it (Gaspar, 2020). The most contentious dispute is currently between the USA and China, while Russia leans towards the East or towards the middle depending on who is living in the White House. What the EU needs to keep in mind, and many Eastern countries do not need being reminded, is that the USA no longer provides unconditional protection via NATO, and Russia is the serious enemy watching at the gates. The American political arena is so polarized that the USA cannot be understood as a reliable partner. Of course that does not mean that China and Russia should. A strategic partnership with Russia or China in detriment of the Atlantic is simply unconceivable. The shared Western values make the opportunity cost of breaking the existing order unbearable, which explains the "high levels of tolerance and patience EU member states and leaders have already been able to display in the face of President Trump's unclear agenda"

(Hosli, Campioni-Noack, Johnson, & Wu, 2020). The main implication is the increasing need for strengthening the European military capabilities.

From the economic standpoint, the USA-China-EU is the central triangle. There is a growing disentanglement between the USA and China (Owen J. , 2021), and the USA wants the EU to pick sides. It is up to the EU and its member states to decide if they are willing to do so. It is virtually impossible to imagine a scenario where all 27 member states agree on this. Therefore, this question will remain contentious, and we will continue to witness the EU voicing a bias towards the USA sphere of influence, while most of the countries try to reap the benefits of the middle ground. The same can be presumed in China's neighborhood, where no state can afford to put all its eggs in an American basket under such uncertainty about the USA's willingness to be a reliable and principled hegemonic guarantor of the world order.

There are economic issues between the USA and the EU with more media coverage: "It is the issue of foreign investment in sensitive sectors, *unfair* trade and foreign debt holdings that has arguably become a leading destabilizing factor when it comes to Sino-American-EU relations" (Hosli, Campioni-Noack, Johnson, & Wu, 2020).

Put simply, 5G is the most advanced generation of telecommunications to date and permits a faster and lower latency communication. Its main contribution is the boost of the *Internet of Things*, which can be understood as having all the devices communicating with each other. There is an economic and a security angle to this issue. Economically, 5G is expected to soon be worth ~1.5 Tr USD/year (PWC, 2021). The security angle is that governments with access to the telecom equipment also have access to the information flowing on it (Dilanian, 2020). As such, it is impossible to distinguish the security concerns voiced by the USA about European usage of Chinese 5G equipment providers and the economic implications of adhering or not to such demands. At the beginning of the fight, Huawei was clearly ahead in 5G and Ericsson (a European company) was the closest follower, while there was no advanced American

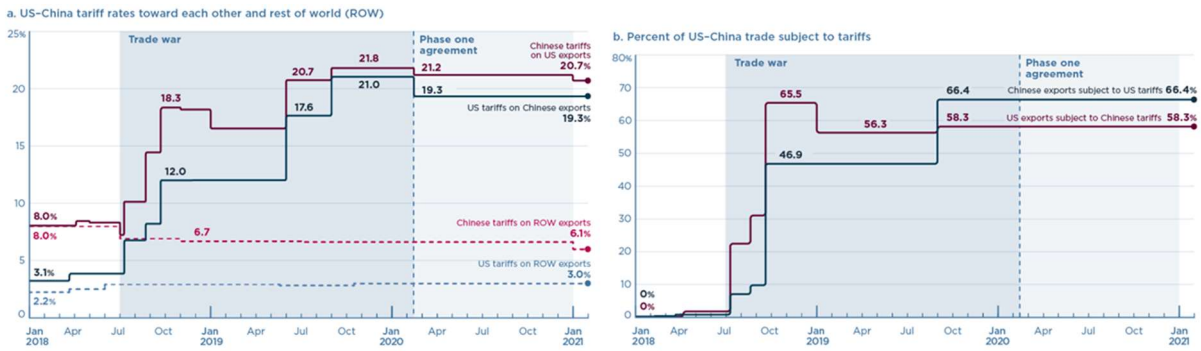
contender. With the delay in deployment of Chinese 5G in the EU, the USA is able to gain time to Ericsson, Nokia and American contenders, and reduce the economic and technological economies of scale of Huawei. But it is important to understand that the slow adoption in the EU (and the USA) allowed China to get ahead in the 5G and was the first large country with nationwide deployment (Global_Times, 2021). This offered a first mover advantage in all 5G applications, which have sizeable economic potential. The decision to allow procurement of 5G equipment from Chinese suppliers is among the most important geopolitical decisions recently faced by the EU and its member states and is far from (Poggetti, 2021).

Portugal has been delaying the decision as much as possible and is on the verge of being the last EU state to deploy 5G (News, 2021).

When Trump got to the White House, the USA had an important trade deficit, with China concentrating the bulk of the problem, distantly followed by the EU (Breuss & Christen, 2019). The problem with China is transversal across product categories, whereas with the EU the trouble resides in steel, aluminum, and transport equipment (mainly automotive, but the rivalry between Airbus and Boeing cannot be ignored).

Figure 57 shows a timeline of the evolution of the USA-China trade war. On the left, it shows the evolution of the average tariff rates among the two countries and against the rest of the world. While the first grew to ~20 percent, the latter remained low. On the right, it shows that the proportion of trade that is targeted grew from ~0 percent to 60 percent bidirectionally.

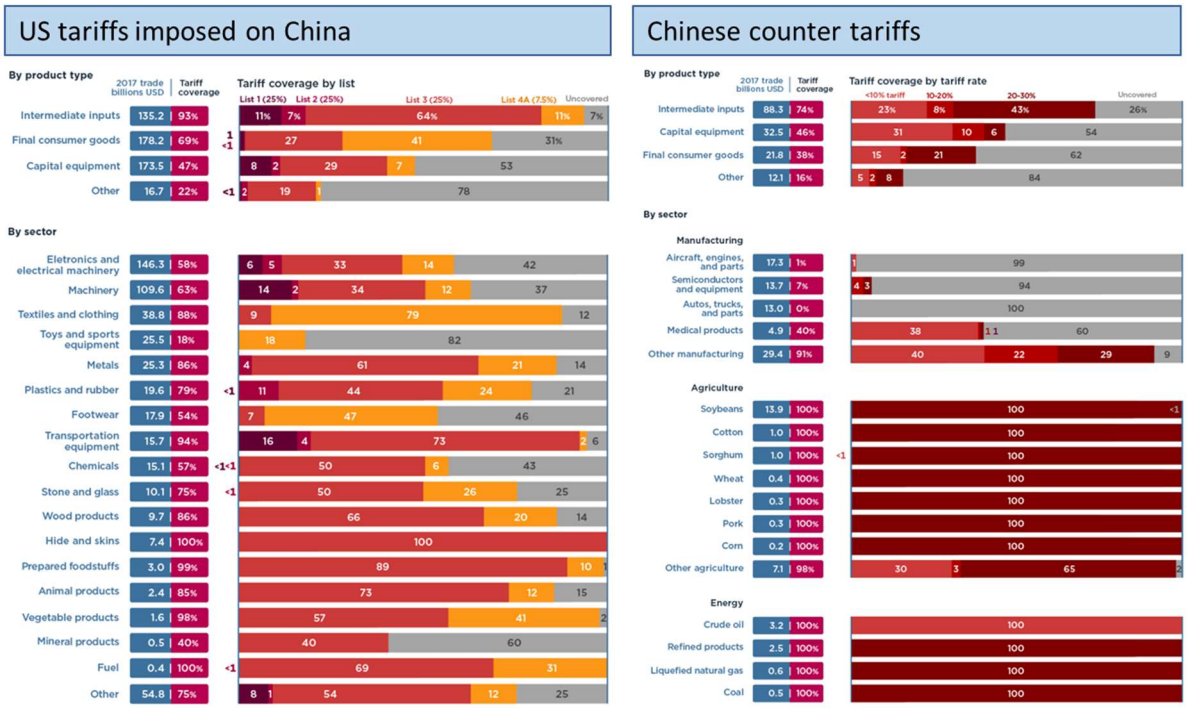
Figure 57. USA & China trade tariff escalation in 2018-2020



Source: Based on (Bown, 2021)

Figure 58 shows that the American tariffs were very generalized whereas China's counter-tariffs were more concentrated on agricultural products and seafood.

Figure 58. USA Tariffs and Chinese counter-tariffs by product



Source: Based on (Bown, 2021)

The Biden administration was confronted with the EU-USA-China trade and FDI triangle as soon as it got to office, by the signing of the agreement in principle for the CAI, between the EU and China. The EU, led by Germany, demonstrated that it is considering to remain neutral on this topic.

As mentioned, Nye shows that power is globally distributed as if in a three-dimensional chessboard with the military in the top, economics in the middle, and transnational relations in the bottom. In the bottom arena, China is a crucial partner of the EU, being on matters such as the environment, Eurasian security or global health (as the COVID pandemic showed). Recent times have shown that the EU cannot rely solely on the USA on these topics: (1) Trump's withdrawal from the Paris Agreement was mitigated by a tight EU-China position; (2) the middle eastern mess created by the Iraq invasion has larger implications to the Eurasians than those in the Western Hemisphere; and (3) the USA has put *America First* in the pandemic.

The existing liberal order was created by the West, and its arrangements "are primarily reflecting the preferences and interests of their main founders, the developed countries of the West. Therefore, there should be no surprise that China perceives them as reflections of Western dominance" (Can & Soto, 2020). China is interested in safeguarding these arrangements which allowed it to grow to its current position. But China also needs "to strengthen the legitimacy of the existing arrangements in order for them to better reflect the interests of the developing world". As such, "China has emerged as an active *order-shaper*, seeking to reform the existing arrangements from within and from the outside". China must secure the cooperation from other powers, "but increasing USA unilateralism and protectionism leaves the EU as the most important partner for China to achieve this end" (Can & Soto, 2020).

Finally, it is important to discuss potential scenarios for the evolution of this triangle. According to Owen, "if globalization is the progressive opening of more and more state borders to greater flows of money, goods and services, people, ideas, and so on, then de-globalisation is the progressive re-closing of those state borders" (Owen J. , 2021). And if the Liberal International Order (LIO) is understood as the set of ideas and institutions that the USA and "its industrial-democratic allies set up after the World War II to regulate economic relations, promote democracy, and strengthen global governance across a number of issue-areas" then "de-globalisation must cast into doubt the future of the LIO" (Owen J. , 2021). If we believe that this may intensify in the future, the question is what will come after the existing global order. Owen sees three options (1) *return to closeness* "where international interdependence is low and great powers worry acutely about access to raw materials, compete for territorial rights, and risk and threaten major wars with some regularity"; (2) *muddling through* "in which openness and a rule-based international order persist but in reduced or stagnant form"; or (3) *the emergence of two overlapping international orders*, "each relatively open internally but less open to the other. One would be led by the USA, the other by China". In the third scenario,

which is Owen's novelty, the USA would maintain the LIO, whereas China's sphere of influence would adopt an authoritarian-capitalist international order (ACIO), "emphasizing not only trade and investment but also sovereignty, authoritarian government, and state-led development. Goods and services, capital, and people would continue to move back and forth between the LIO and ACIO, but to a lower degree than they move within each order" (Owen J. , 2021). This scenario uses the Darwinian notion of *niche construction* to suggest that the American and Chinese drives to sustain their political systems end up being the key driver of the emergence of the new order.

3.d. The Portugal-China relationship

3.d.i. Political and economic models of Portugal

The current Portuguese political model dates back to 1976. The revolution of 25th April 1974 ended the authoritarian *Estado Novo* regime, which lasted 41 years. The first two years were very turbulent, and the communist drift included nationalizations and forced salary increases, which dramatically decreased productivity. On 25th November 1975, the country got on track to pluralism and democracy. The cornerstones of the 1976 Constitution (revised seven times since then) are republicanism, the rule of law, the democratic system, the sovereignty of the people, the separation of powers, and the regional autonomy. The regime is semi-presidential with a parliamentary bias, and the institutions of sovereignty are the President of the Republic, the General Assembly (i.e., the *parliament*), the Government, and the Courts (Portugal, 2021). The President (Head of State) and the parliament are directly elected through secret and universal voting. The 230 assemblypersons are elected through plurinominal closed lists determined by the political parties, via proportional representation and the *D'Hondt* formula. The parliament's main task is to legislate. The executive is headed by the PM who is nominated by the President after hearing the parties represented in the parliament. The head of the winning party is generally nominated PM, but for that he needs a parliamentary majority willing to approve its *Government Plan* (which details political orientations and initiatives to be implemented across the governmental domain). The current Government is led by the Socialist Party because the winning center/right coalition, which was previously in power, could not secure a parliamentary majority, whereas the Socialist Party could (with the left-wing parties). The President represents the Republic and is responsible for guaranteeing the national independence, state unity and the regular functioning of the democratic institutions. He is the Chief Commander of the Armed Forces and responsible for enacting laws proposed by the

Government and approved by the parliament. Such laws can be approved, sent to the Constitutional Court for validation or vetoed (only once) by the President.

Portugal is "administratively divided into 308 municipalities, subdivided into 3,092 civil parishes" (EU, 2021). The Madeira and the Azores archipelagoes, are autonomous regions with their own assembly and regional government, directly elected by their populations.

Portugal stated its interest in joining the EEC in 1976 and presented its application in 1977. According to Professor Durão Barroso, interviewed for this thesis, the participation in the European project was more political than economically driven. The attractiveness came rather from the political capital and stability that it would provide than from the economic benefits that would come along. Since then, the population and the political leaders have been generally favorable to broader and deeper European integration.

Portugal witnessed strong growth until 1973 (Figure 59), consistently growing 5-10 percent because of the economic opening strategy pursued since the mid-1950s. There was a severe crisis in 1974-75 due to internal factors such as revolutionary convulsions and decolonization effects, plus external factors, such as the oil prices shock (Lopes, 2002).

Figure 59. Portugal real GDP growth rate. %



Source: (PORDATA, 2021)

After joining the EEC, Portugal started 10 years of political stability under PM Cavaco Silva, who implemented several structural reforms, privatizations and dropped protectionist trade barriers. The economic growth was strong until 1990 but since then, due to the need to control the rampant inflation (Figure 60) and ensure a nominal convergence with the ECC, contractionary anti-inflation policies were implemented, which led to economic recession.

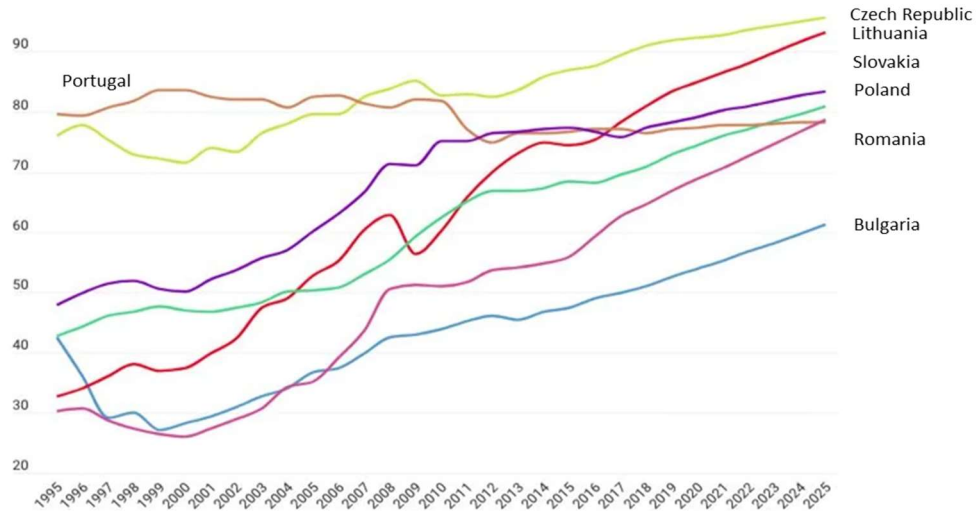
Figure 60. Portugal inflation rate. %



Source: (PORDATA, 2021)

The economic growth in 1995-1999 is explained by the drop in the interest rates and the expansionary policies that started the escalation of the public debt. And here lies the most important feature of the current economic model, which is problematic to say the least: by joining the EMU at an unfavorable exchange rate, and losing control over its monetary policy, Portugal embarked on a journey of stagnation, resulting from the deterioration of the exports' competitiveness. It is possible to argue that the EU meant a phenomenal institutional progress but an economic disaster with dire consequences (Amaral, 2016). Portugal's GDP per capita diverged, being today at a lower percentage of the EU average than it was in 1995 (Figure 61).

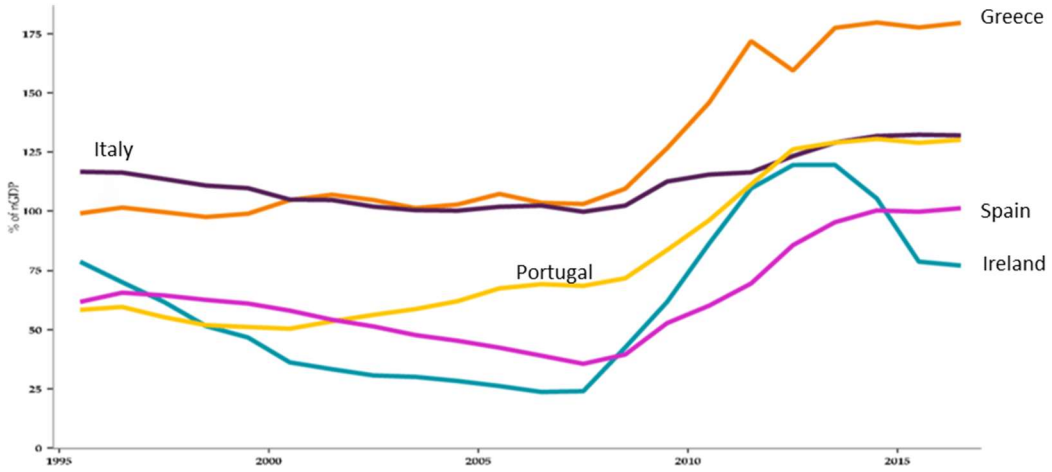
Figure 61. GDP per capita, PPP, vs. UE28=100



Source: (Vinha, 2020)

Besides the stagnation, Portugal and other peripheral countries accumulated too much debt which led to very weak public finances in the eve of the financial crisis (Figure 62). These countries were out competed by the CEE countries which joined the EU later… and by China (Alexandre, Aguiar-Conraria, & Bação, 2016).

Figure 62. Gross Debt to GDP ratio



Source: (Akram, 2017)

The Portuguese economy has many problems, such as labor market rigidity, poor qualification, slow judicial system, but the main problem resides in the lack of productivity (of labor), which is rooted in the lack of capital. Capital is scarce because what existed was nationalized in the 1970s but also because the capital that was made available after that (e.g., EU funds) was invested in low productivity and non-tradable sectors (Amaral, 2016). Portugal does not control its currency, the EUR is kept too appreciated for its needs and it is too indebted to be able to promote investment or even GDP growth via Government spending. As of 2020, agriculture accounts for 2 percent of GDP and industry accounts for 19 percent of GDP, while vehicles and machinery are the most exported products (Figure 63). Tourism, which used to account for 4 percent of the Portuguese GDP grew steadily from 2011 to account for 8.5 percent in 2019.

Figure 63. Portugal's top exports 2020

1. Vehicles: US$8.6 billion (13.9% of total exports)
2. Electrical machinery, equipment: $5 billion (8.2%)
3. Machinery including computers: $4 billion (6.5%)
4. Plastics, plastic articles: $3.2 billion (5.1%)
5. Mineral fuels including oil: $2.9 billion (4.6%)
6. Knit or crochet clothing, accessories: $2.1 billion (3.4%)
7. Furniture, bedding, lighting, signs, prefabricated buildings: $2 billion (3.2%)
8. Paper, paper items: $1.9 billion (3.1%)
9. Optical, technical, medical apparatus: $1.8 billion (2.9%)
10. Footwear: $1.8 billion (2.9%)

Source: (Workman, 2021)

To unblock the current situation Portugal would have to either implement protectionist measures or leave the EUR to depreciate its currency, but both situations would have unpredictable political, economic and social consequences. The Portuguese are a conservative political body, and the population would not be in favor of any dramatic move. As such, according to Amaral, Portugal has three potential paths moving forward. The positive or lucky scenario, in which a strong economic power sees in Portugal the place to promote global scale and highly productive activities. This scenario is analogous to the American FDI in Ireland which pushed the country from the bottom of the EU to its podium (Hwang, 2014). The negative scenario is the abandonment of the EU and/or the Monetary Union and a default on the sovereign debt which would mean a dramatic loss of credibility with grave consequences (Amaral, 2016). A subjective scenario (depending on one's values) is one where Portugal becomes a region within a (European) federation and is subsidized by richer states. For nationalists, this is the worst nightmare, but for some constituencies it is the way to go. Since Amaral wrote this essay, there was a tourism-driven recovery followed by its collapse due to the pandemic. As of 2021, it is neither possible to foresee what will happen to that growth engine nor the impact of the post-COVID EU funds. Building upon his scenarios, some people may try to use China's wallet as a proxy for the American-Irish case. Would that be feasible? What implications would it have for the relationship with Brussels and Washington?

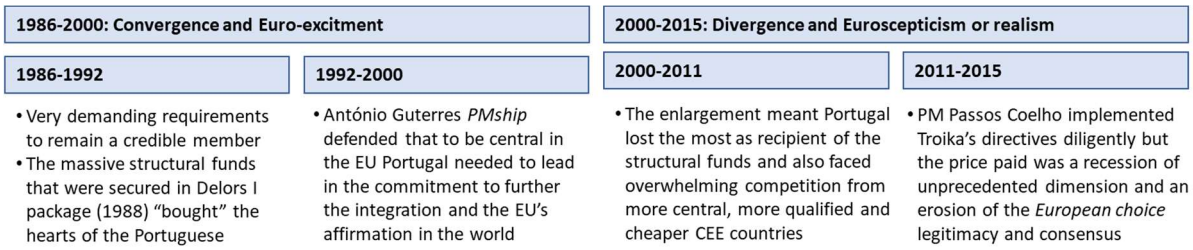
3.d.ii. Portugal and the EU

The post-revolution strategy for economic development was based on the accession to the EEC. Portugal was on the front line of the deepening of the European integration which led to the creation of the single currency (Alexandre, Aguiar-Conraria, & Bação, 2016). Mário Soares, who was the main political leader, stated that he decided for that strategy out of a gut feeling, despite the opposition from all the reputable economists of the time (Soares, 2010). The decision was much more political than economic because politics must come before economics and the alternatives were much worse politically (Soares, 2010). Some economic advantages were expected such as the structural funds that came in: EUR 98 Bn (Alexandre, Aguiar-Conraria, & Bação, 2016). At the same time, economic orthodoxy was very accurate in forecasting that the accession at such high exchange rate, combined with the increased competition from the central European countries, which were much better positioned geographically, would lead to lower productivity, which, after the inebriation of the structural funds, would result in economic stagnation and over-indebtedness.

Before the revolution, Portugal was not as isolated as Spain: it was part of NATO and the European Free Trade Association (EFTA). But it was autocratic and colonial, so it could not participate in the European project. The adoption of the democratic model and the participation in the EU are two faces of the same coin: the European Portugal substituted the colonial Portugal, Europe legitimated the democracy and the democracy legitimated the European choice. Therefore, since 1977, Europe was the absolute priority in the Portuguese Foreign Policy (Teixeira, 2017). The accession to the EEC was also the main argument to subtract from the Constitution and the economic policy the communist and militaristic excesses of the post-revolutionary period. For example, the nationalized companies were re-privatized, the Revolution Council was terminated, and the armed forces were subjugated to the democratic political power (Teixeira, 2017).

The relationship between Portugal and the European project can be divided in four periods (Figure 64) which explain the evolution from a committed member to a leader of the integration process, to the main loser of the enlargement, to the best student of Berlin as a survival strategy.

Figure 64. Evolution of the Portugal-EU relation in 1986-2015



Source: By the author based on (Teixeira, 2017)

The Troika intervention also required a massive privatization program in a moment of limited demand, which led to the sale of several important (some even strategic) assets to Chinese and Angolan investors, followed from afar by the USA, France and Brazil (Figure 65).

Figure 65. Key facts about Troika's privatization program

	MAIN INVESTORS	STAKES SOLD	AMOUNT IN EUROS
edp	中国三峡	21.35%, at a premium of 53.6% per share	EUR 2 693 million
REN	国家电网公司 State Grid; Oman Oil Company	40%, at a premium of 33.6% per share 11%, at a discount of 6.3% per share	EUR 593 million EUR 157 million
ANA	VINCI	100%	EUR 1 127 million for the shares + EUR 1 200 million for the concession fee + EUR 753 million of pre-existing debt
ctt		100%	EUR 910 million
FIDELIDADE	FOSUN 复星	80% of Fidelidade, Caixa Poupança, Multicare and Cares	EUR 1 000 million
		1% for GALP	EUR 101 million
HPP Saúde	Amil	HPP (CGD Health)	EUR 85.6 million
EGF		100%	EUR 149.9 million
CP CARGA S.A.	msc	100%	EUR 53 million
TAP	atlantic gateway		

Revenues of around EUR 9 billion, above initial expectations of EUR 5 billion.

Source: (AICEP, 2016)

The sales to Angolan investors have already witnessed poor outcomes with a change in the African leadership resulting in the demise of the specific shareholders (e.g., Isabel dos Santos, daughter of former President José Eduardo dos Santos). COFDI is analyzed in Chapter 4.

The integration in the European project has meant a gradual drainage of sovereignty by giving way to the supranational institutions authority over an increasing number of policy areas.

Additionally, the deepening of the European project led to the proliferation of regulatory bodies which limit the governments' bandwidth across several sectors. At the same time, because the governments play an almost monopolistic role in the interaction with the EU institutions, it also serves as an external legitimator for policies which would otherwise be harder to defend from the domestic opposition (Jalali, 2017). The elections for the European Parliament have the lowest attendance among electoral processes in Portugal and tend to be highly influenced by domestic politics. At the same time, the enlargement, the subsequent crisis, and the harsh remedies imposed by Troika reduced the excitement and consensus around the EU project in Portugal. And yet, the EU project remains the only viable alternative for the majority of the political leaders and the population.

For the EU, Portugal is a medium-sized country, representing ~2 percent of its territory (92,200 km^2), 1.5 percent of the GDP and about 2 percent of its population (10.3 Mn), despite having a lower fertility rate (1.36 vs. 1.6) and an older population than the EU average. Portugal's trade is very concentrated in the EU, which accounts for 76 percent of its imports and 74 percent of its exports. In 2018 the EU was spending EUR 5 Bn/year in Portugal, while Portugal was contributing with EUR 1.7 Bn/year to the EU budget (Eurostat, 2018).

Portugal is a very engaged member and several Portuguese leaders have led important European and or multilateral institutions (e.g., Former President of the EC Durão Barroso, former President of ECOFIN Mário Centeno, current Secretary General of the UN António Guterres, Director General of the International Organization for Migration António Vitorino).

3.d.iii. The Foreign Policy of Portugal

The understanding of the Portuguese foreign policy must start from the *Strategic Concept of National Defence*, approved by the Council of Ministers in 2013, which substituted the previous one from 2003. It outlines the state's priorities according to the national interests and is constrained by three main inputs: NATO's 2010 strategic concept, the Treaty of Lisbon and the Troika intervention.

The fundamental values outlined are: "national independence, the primacy of the national interests, the defence of the principles of Portuguese democracy and of HR and international law, the commitment to defend European, Atlantic and international stability and security" (Portugal, 2013). Portugal's interests are: "to assert its presence in the world, to consolidate its participations in a solid network of alliances, to defend the state's external stand and credibility, to value the Portuguese communities abroad, and to contribute to the promotion of peace and international security" (Portugal, 2013). Due to the lack of resources and need for a stable and coherent network of alliances, the EU, NATO and the CPLP are considered vital. Nevertheless, it is also "important to deepen or establish strategic partnerships with other members of the European and Western community, with the Lusophone space and also with the Maghreb and with emerging powers" (Portugal, 2013). Former PM Passos Coelho, who headed the Portuguese executive when the strategic concept was approved, shared in his interview that "China may intersect more with the Portuguese interest in the CPLP, since there are very significant Chinese investments there*"*. For him, China is not a main pillar of Portugal's strategy, even if it is a very important and rising power which cannot be ignored and a country which generates very large amounts of liquidity to invest abroad.

There is also a 2018-2021 *Strategic Directive of General Staff of the Armed Forces* (Armed-Forces, 2017). Its vision is "serving Portugal with relevance, contributing to construct the Armed Forces of the future", and its mission is "to guarantee the military defense of the

Republic, contribute to the national and international security and to support the development and the well-being of the populations". Its driving values are discipline, loyalty, honor, integrity and bravery.

The literature about the Portuguese foreign policy is relatively consensual around a few ideas. The first idea is that Portugal has always been European and Atlantic at the same time. Geographically, Portugal has only one terrestrial neighbor and has always (until recently) felt pressure to find in the Atlantic a balancing power to counterweight Spain. For that reason, Portugal has always sought and secured an alliance with the dominant maritime power (first with Britain and then the USA) and maintained a significant Empire overseas (Teixeira, 2010). But during the *Estado Novo,* the autocratic nature of the regime created bidirectional skepticism in the Atlantic. For example, during World War II Portugal was initially *de facto* neutral, and gradually moved to a *collaborative neutrality*, mostly through the Allied presence in Azores, but also by stopping the supply of wolfram to Germany (Sá, 2015).

After the revolution, the Armed Forces Movement determined a radical change of the Portuguese foreign policy by defining as priorities: democratization, development and decolonization (Sá, 2015). With time, the current foreign strategy solidified around 3+1 pillars: the commitment to the military alliance with NATO, the *European option*, the development of a tight cooperation with the CPLP (created in 1996) and the participation in the production of international security via NATO, the EU and UN missions (Teixeira, 2010). In tandem, Portugal radically changed its position regarding Spain and developed what can be considered a close friendship and significant interdependence (Teixeira, 2010). It also introduced a normative logic, committing to the upholding of democracy, rule of law and human security (Teixeira, 2010). Within the EU, which is by far the most important component of the strategy, the first vector is to be always in the forefront of the integration process to compensate geographical periphery with political centrality (Teixeira, 2010). Additionally, there has been a clear choice

of aligning with the dominant regional power (Germany). It is possible to argue that the most dilemmatic dimension of the Portuguese foreign policy is the tension between defending its interests vs. defending its values (Teixeira, 2010). Portugal tends to deal with this dilemma by defending its interests within the very limits of its capacity, many times beyond what its rhetoric enunciates. The relationship with China is an example of that. Portugal has a long-standing relationship with China, which is covered in the next section. What is important to mention at this point is that while it is in Portugal's interest to deepen and exploit further its relationship with China, Portugal does so as much as possible within the limits of being considered too close to China. The economic benefits of engaging with China are obvious, particularly the attraction of COFDI and the exports to China. On the negative side, Portugal is pressured by some constituencies to confront China regarding its HR practices. Recently, it is increasingly pressured by the USA to reduce its economic engagement with China, namely about COFDI in strategic assets or sensitive sectors. The mainstream view has been that there is no alternative to the EU as a strategic priority and the relationship with the USA is so important from the strategic standpoint that it cannot be put at risk under any circumstances (Sá, 2015).

In 2020, the MFA Santos Silva published a book which presents a quasi-official position of the current Government on foreign affairs. When invited to contribute to this thesis, the Minister referred to this book as the ultimate synthesis of his views. A novelty in his proposal is that the Portuguese foreign policy changed from four pillars to six pillars (Silva, 2020).

First, the European option, where Portugal is no longer a passive exemplary student but rather a policy-maker, a defender of the heterogeneity of the European states, and promoter of further integration or at least improvement of the existing institutions. The minister is particularly assertive regarding the need to improve the monetary union, the budgetary allocations, and the implementation of the PESCO (Silva, 2020).

Second, the transatlantic ties, which are centered in the USA (and NATO) but extend to Canada and the UK in the north, all the way to Brazil and Western Africa in the South. Portugal should not adhere to the often-mentioned notion that the new century is the century of the Pacific.

Third, the CPLP, anchored around the common language. This lever can be pulled across several issues ranging from the economic to the concerted influence in multilateral organizations. The relationship with these countries shall be fostered in the CPLP itself but also bilaterally (Silva, 2020).

Fourth, the Portuguese communities abroad, which today include different generations and a heterogenous base which must be leveraged for political influence, international image, bilateral relations, FDI and trade, remittances, revitalization of low-density territories, and promotion of the Portuguese language and culture (Silva, 2020).

Fifth, the internationalization of the Portuguese economy, language, culture, science and international cooperation. Portugal has multiple institutions involved in such process, including but not limited to AICEP (investment and trade promotion), the Camões Institute (Portuguese language teaching), SOFID (a Development Bank from the Ministry of Foreign Affairs), the embassies and the consulates (Silva, 2020).

Finally, the commitment to the promotion of multilateralism, which goes beyond active participation, and advocates multilateralism as the key to preserve and improve the international order, through the UN and other multilateral institutions, under the primacy of the international law (Silva, 2020).

Minister Santos Silva acknowledges an important normative dimension in the Portuguese Foreign policy, namely the triangle democracy, rule of law, and HR in favor of sustainable development, international security, peaceful solution to conflicts and care for the global commons (Silva, 2020). At the same time, this must be understood pragmatically, because

Portugal also pursues its interests and is not willing to commit blindly to policy decisions strictly derived from moral considerations (Silva, 2020).

Therefore, despite prioritizing the EU, the Atlantic and NATO, Portugal intends to exploit the legitimate degrees of freedom and its specificities in the consideration of the national resources and interests. This includes the historical ties cultivated with several countries and regions across all continents, and the Portuguese ability to engage with other civilizations in constructive dialogue, avoiding the double standard trap of being permissive with the closest nations and too strict with supposed foes (Silva, 2020). Moreover, Portugal upholds that the EU must have an autonomous and active role in the strategic game going on between the USA, Russia and China (Silva, 2020).

3.d.iv. Portugal-China relationship: past and present

After conquering Goa in 1510, and Malacca in 1511, Portugal moved towards the establishment of trading posts further east. Jorge Álvares was the first Portuguese to arrive in the Middle Kingdom (1513) and the first ambassador was Tomé Pires. Because China was not willing to accommodate the relationship of equals presupposed by the Portuguese envoy, Tomé Pires' refusal of suzerainty was (literally) fatal for him. He was incarcerated and never returned. The Jesuit missionaries, who were the first *de facto* ambassadors of Portugal in China, were the ones capable of advancing the relevance of the relationship, even if they had to prove their worth as teachers before being able to evangelize in the kingdom. During the rule of *Marquês de Pombal* (1750-1777) the Jesuits were expelled from Portugal, reducing the nation's influence in the Chinese Court (Mendes, 2016).

Despite not being involved in the *Opium Wars*, Portugal was only capable of securing effective control over Macau with the *Friendship Treaty* of 1887, which established the occupation and perpetual rule over the region.

During the autocratic rule of Salazar, Portugal did not recognize the PRC and maintained diplomatic relations with Taiwan. Nevertheless, the relationship between the two countries was secured through Macau. Recovering Macau and HK was not a priority for Mao and the CCP's Commercial Enterprise *Nanguang* worked as a shadow Government effectively controlling Macau's economic life (Mendes, 2016). More importantly, Macau worked as an off-grid trading post through which China could access strategic inputs from the outside world (e.g., during the *Korean Wars*). On 12th December 1966 there was an upheaval which resulted in the loss of control by the Portuguese administration, but the Governor Nobre de Carvalho was clearly instructed by Salazar to endure all humiliations necessary to maintain the official status of Macau, since it was a symbol of the Portuguese Empire in the Far East (Mendes, 2016). Still during the *Estado Novo*, but already under Marcello Caetano, in 1971, Portugal agreed to

support the substitution of Taiwan by the PRC in the Security Council of the UN and one year later China demanded that Macau (and HK) was removed from the list of non-autonomous territories. With this change, Macau became an internal Chinese issue. In Portugal, in 1976, it was officially approved that Macau was a territory under Portuguese Administration and not a colony. It was also part of the deal between the two nations that Portugal would respect the *one country, two systems* formula and would not allow foreign (or Taiwanese) usage of Macau for activities subversive to the mainland (Mendes, 2016).

In 1985, China informed Portugal that it was time to handover Macau, and after a reasonably smooth negotiation, it took place on 20th December 1999 (two years after HK). According to former PM Cavaco Silva, the main concern for Portugal was to end the Empire with honor. Because it became clear that Portugal had some leverage arising from the Chinese intention to have a negotiated outcome, Portugal also pushed for other concessions among which were the dual nationality of the Macanese[7], the maintenance of the Portuguese as one of the official languages, and a land concession for the international airport of Macau. A notable feature of the negotiation was that it did not stop despite the Tiananmen incidents, contrary to what happened with the HK negotiations (Mendes, 2016).

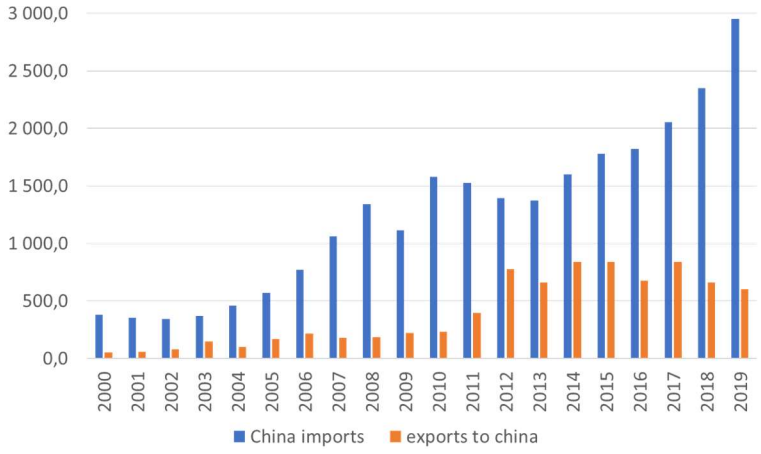
The relationship between Portugal and China has since secured a status well above the Portuguese fair share. First and foremost, the Portuguese diplomacy has been consistently open to genuine constructive dialogue. Second, the people-to-people ties created during the transition period, and the economic ties emanating from centuries of economic cooperation in such an important trading post cannot be disregarded. Illustratively, the current Minister of the Interior and the current Minister of the Economy of Portugal (along with Dr. Lacerda Machado from the Macau Forum) were stationed in Macau in the 1980s to deal with the transition and have

[7] The final agreement was such that they could use the Portuguese nationality abroad but within China they are only Chinese.

nurtured local trust relations for long. Beyond that, Portugal is also recognized for its potential role in the relationship between China and the CPLP, as the Forum Macau indicates.

Portugal and China signed on 9th December 2005, a comprehensive *strategic partnership,* which aimed to strengthening the economic ties, but also established frequent high-level summits and bilateral cooperation across several domains. In 2019 Portugal and China upgraded their relationship to the level of *strategic dialogue* which puts Portugal "on the highest tier, along with Germany, Canada, France or the UK. It establishes annual consultations between the MFAs about all critical subjects of international politics" (Silva, 2020). With time, the interdependence has intensified through tourism, trade, and most importantly FDI, particularly since the financial crisis. Tourism which was yielding EUR ~130 Mn from 350,000 Chinese tourists in 2018, was expected to triple until 2025 before COVID-19 (Cerqueira, 2019). Regarding trade (Figure 66), while imports from China have grown to four percent of total imports, exports to China have only grown to one percent of total exports and were lower in 2019 than in 2012.

Figure 66. Portugal – China trade



Source: (PORDATA, 2021)

A few Portuguese companies are already established in China with relative success (e.g., Delta, Hovione, Corticeira Amorim, Filstone Natural, and several wine groups) but these remain exceptions: "In 2017, there were 1,451 Portuguese companies exporting to China. But the trade

balance is very uneven" (Silva, 2020). COFDI, is the most influential source of economic integration and it is important to keep in mind that it was significantly touted by the Portuguese Governments, meaning that it was mostly pulled, not pushed. But outside the COFDI attraction efforts in the 2010s, the relationship has been more pushed by the Chinese side. The Pearl River Delta mega city (which includes Macau, HK, and nine cities from Guangdong) is one of the most important Chinese projects under development and Macau is central it (Routley, 2018).

In his interview, former Vice-PM Paulo Portas shares that the previous right-wing Government (2011-2015) saw in China the possibility to diversify Portugal's network of interdependences. Despite acknowledging the concerns that the EU wants to address in its relationship with China, Portugal has been able to avoid a moralizing political stance, which is appreciated by the Chinese counterparts (Mongiardim, 2018). To understand the current positioning of Portugal *vis-à-vis* China the best source is again the latest book by the MFA Santos Silva. According to him, the relationship between Portugal and China is managed within the EU framework, under a logic of alignment and singularity (Silva, 2020).

The relationship between the EU and China is "complex but necessary" (Silva, 2020). One of the main themes of interaction today is the participation of several EU countries in the BRI and its coordination with the *EU-China Connectivity Platform*, approved by the EU in 2015: "In the summit that took place on 9th April 2019, the EU and China defined the articulation of the strategy for connecting Europe and Asia with the BRI as a common goal" (Silva, 2020). The necessity of the relationship, he believes, is self-explanatory: "China, a country with 1.4 Bn people and the world's second largest economy, and the EU, the most successful political union of several States, with more than 500 Mn inhabitants, that is concurrently the most open economy on the planet, cannot go by ignoring each other" (Silva, 2020).

The complexity of the relationship is rooted in three fundamental conditions: first, China needs to open further economically and accept to play in a level playing field: "China needs to open

its markets to a greater extent, namely in public procurement, and through the observance of contracts, IP rights and anti-dumping rules"; second, the need to ensure security of critical infrastructures, which include the "possibility that the access to the so-called 5G technologies and communication networks may be connected to the possession of relevant strategic information or personal data by foreign States"; third, the respect for HR. The EU sees progress in the assurance of economic, social and cultural rights, but perceives "a setback in terms of civil and political rights, because of the application of the death penalty, arbitrary detentions and restrictions to the freedom of speech, opinion and association" (Silva, 2020).

Regarding Portugal's relationship with China, the Minister believes that some circles have erroneously identified a supposed Portuguese over-dependence from China: data shows that Portugal is the 8th or 10th COFDI destination in the EU, with first places being occupied by the UK, Germany, Italy and France. Moreover, in 2018, China was Portugal's 6th supplier and 13th goods importer (Silva, 2020). Portugal deals with China always upholding its commitment with the EU and NATO, and in signing the MoU of adherence to the BRI "Portugal insisted on laying down in writing that any cooperation under this memorandum should observe the EU rules and principles, and respect for international obligations" (Silva, 2020). Simultaneously, the "longevity and particular nature of the Portuguese administration of Macau, the transition to Chinese sovereignty in 1999, and the way both parties have since then complied with their obligations have added a certain uniqueness" to the relationship. He questions why should Portugal "let all these aspects that matter so much to Asian cultures go to waste?" (Silva, 2020).

All in all, the key positioning is that Portugal and China are partners, not allies:

> "We are already cooperating, and may extend our cooperation in diplomatic, educational, cultural and economic terms, but we are not cooperating bilaterally in matters of defence and security, nor are we aligned in terms of geopolitical and strategic positioning. In these areas, the collaboration framework is the UN (or China's partnerships and dialogues with the EU and NATO)." (Silva, 2020).

Portugal acknowledges its interdependence, but does not foresee a dependence on China: "Portugal is neither is indebted with China, nor negotiates any initiative with this country that implies the transfer of ownership or control over public infrastructures or the exercise of corporate capacity, namely in the regulated sectors, outside of the Portuguese and EU laws" (Silva, 2020). As an example, regarding the 5G network, Portugal is "taking into consideration all the information provided by our allies, as well as following the strategy outlined by the EU – but we are not replacing analysis with prejudice" (Silva, 2020).

China wants to wield influence in the world, but so does Portugal and most other nations. Differently, China's "revisionist impulse makes it quite clear that this is problematic for a rules-based international order. Thus, we should be determined and careful when defending post-Second World War and post-Cold War international law and order". Debates about how to deal with this complex issue "are welcome; but not those that give in to oversimplification and to the lack of knowledge about history and about the world we live in" (Silva, 2020).

4. From FDI to COFDI in the EU and in Portugal

4.a. FDI definitions, stock and flows

FDI is an investment involving a "long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor) in an enterprise resident in an economy other than that of the foreign direct investor*"* (UNCTAD, 2007). It implies that the investor exerts a "significant degree of influence on the management" of the target. It includes the initial transaction but also all "subsequent transactions between them and among foreign affiliates" (UNCTAD, 2007). The IMF suggests considering FDI "when the direct investor has acquired 10% or more of the ordinary shares or voting power of an enterprise abroad". Conversely, investments <10 percent are Foreign Portfolio Investments (FPI), which are passive holdings of securities as foreign stocks, bonds, or other financial assets, none of which implies active control over the securities' issuer. FPI is more liquid and volatile than FDI.

FDI includes equity capital (acquisition of shares in the target), reinvested earnings (the investor's share of earnings which are not distributed as dividends but reinvested by the affiliates) and intra-company loans (flows between the investors and the affiliates). FDI can be measured as a stock or as a flow and both can be outwards or inwards: "stock measures the total level of FDI […] The OFDI stock is the value of the resident investors' equity in and net loans to enterprises in foreign economies. The inward FDI stock is the value of foreign investors' equity in and net loans to enterprises resident in the reporting economy" (OECD, 2020).

The flow can be assessed in net or gross terms. Net inflows are the balance of new investments deducted from new divestments, whereas gross flows are the new investments alone. Outflows are the investments performed by residents from the reporting country into a different one.

We use UNCTAD database to synthesize global FDI in ten major insights.

The first insight is that FDI figures are just rough estimates. The comparison between the total amounts in figures 67 and 68 shows that the total stock of OFDI and IFDI differ by USD ~2 Tri. The same happens to flows' estimates.

Figure 67. FDI outward stock by economy type (UNCTAD definition)

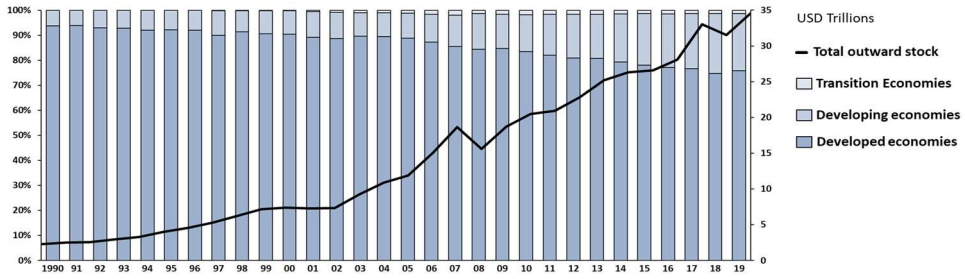
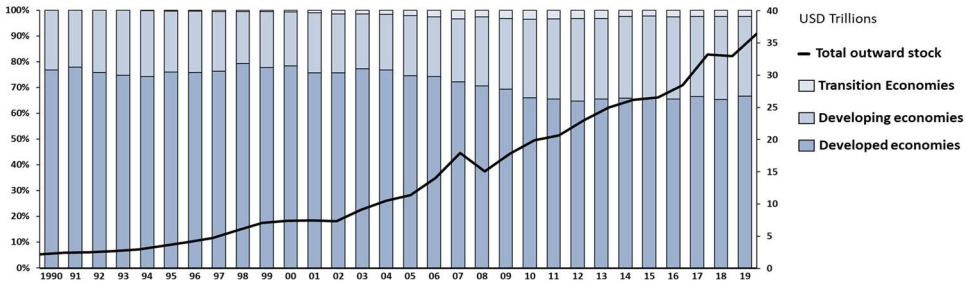


Figure 68. FDI inward stock by economy type (UNCTAD definition)



Source: (UNCTAD, 2020)

The second insight is that FDI grew immensely in the last three decades, from a total of USD 2 Tri to 35 Tri. This is a 17x growth, which compares with global GDP's 8x growth, from USD 11 Tri to 88 Tri, in the same period (World_Bank, 2020).

The third insight is that total FDI decreased in three instances since 1990: the 2001 crisis, the 2008 crisis and the hard break of COFDI in 2018.

The fourth insight is that FDI from/to poor countries has grown faster than FDI from/to richer countries. Using the UN definition of developed/developing nations, the percentage of FDI from developed countries decreased from 94 percent in 1990 to 76 percent in 2019, and the FDI to developed countries decreased from 77 percent in 1990 to 67 percent in 2019. The author dislikes the UN definition because it is outdated in relation to the economic development of the last 30 years (e.g., wealthy HK and Singapore are considered developing).

Therefore, this thesis upgraded the UNCTAD database with WB's *high-income* categorization which uses the *atlas method* to determine what is a high-income economy – GDP per capita of USD >12,536 in 2019 (World_Bank, 2020). After this adjustment, it converts figures 89 and 90 into figures 69 and 70. Because the list of high-income countries includes large FDI investors, their share of OFDI stock is 96 percent in 1990 and decreases to 89 percent in 2019, whereas the share of IFDI stock in high-income countries decreases from 90 percent in 1990 to 81 percent in 2019.

Figure 69. FDI outward stock by income level (WB definition)

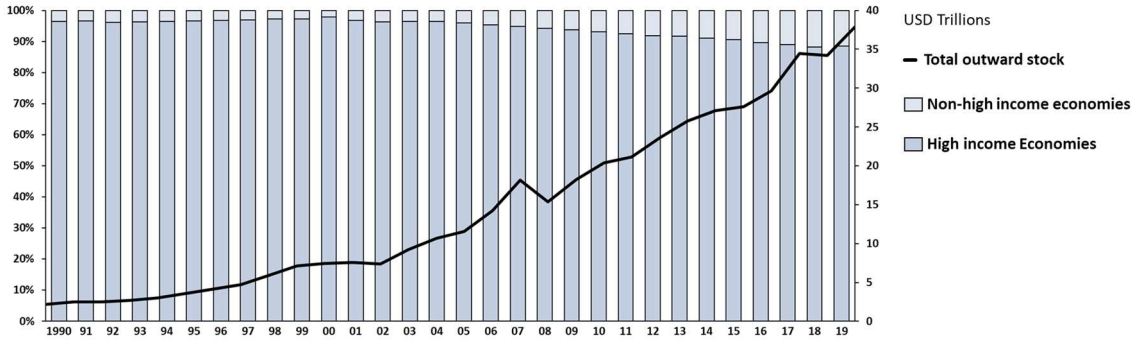
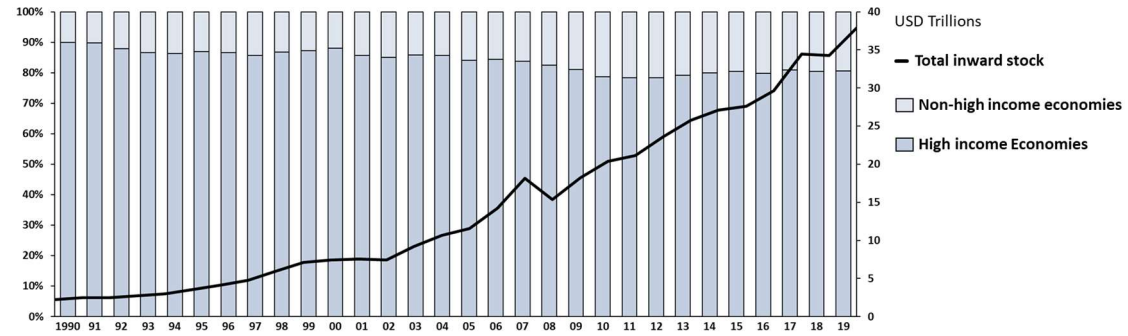


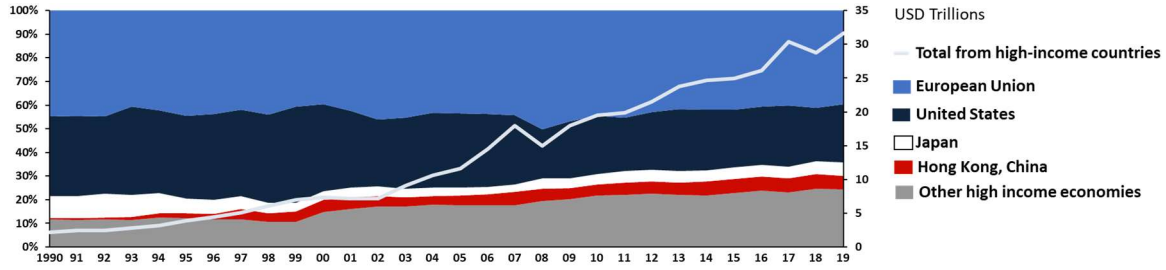
Figure 70. FDI inward stock by income level (WB definition)



Source: (UNCTAD, 2020) & (World_Bank, 2020)

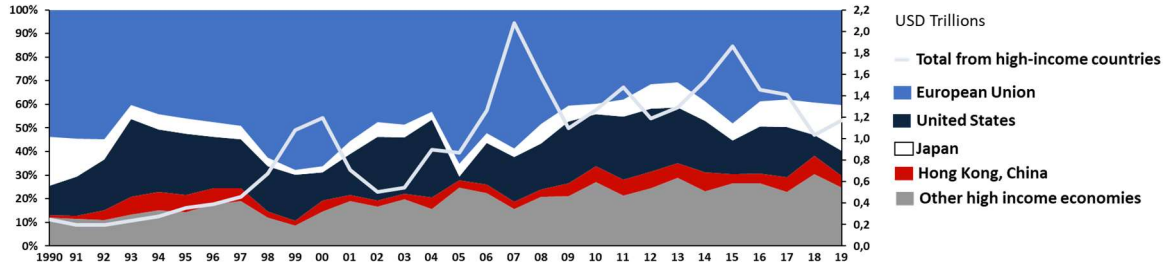
The fifth insight is that the EU, the USA and Japan remain the highest senders of OFDI stock, but their share decreased from 88 percent to 70 percent. Japan decreases from 9 percent to 6 percent, and HK grows from 1 percent to 6 percent (Figure 71).

Figure 71. FDI outward stock from high-income countries



Source: (UNCTAD, 2020) & (World_Bank, 2020)

Figure 72. FDI outflow from high-income countries

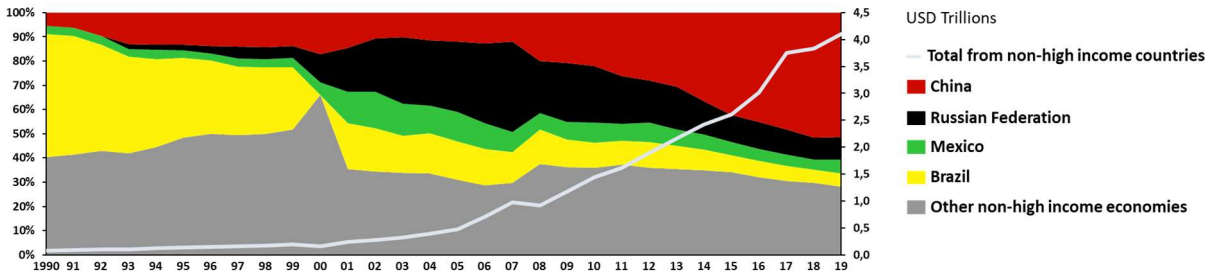


Source: (UNCTAD, 2020) & (World_Bank, 2020)

The EU reduces 5 percent in 30 years, and the USA reduces from 34 percent to 24 percent (was the largest holder in 1990 with USD 700Bn and still is with USD 7.7 Tri). The share of other developed countries doubled from 12 percent to 24 percent, with Canada holding the largest stock. The outflow of FDI from rich countries saw a relative drop of the top 3 economies (Figure 72).

The sixth insight is that China's FDI grew the most among poorer nations (Figure 73), from USD 4Bn to 2 Tri but remaining <17 percent of EU's OFDI and <27 percent of USA's OFDI).

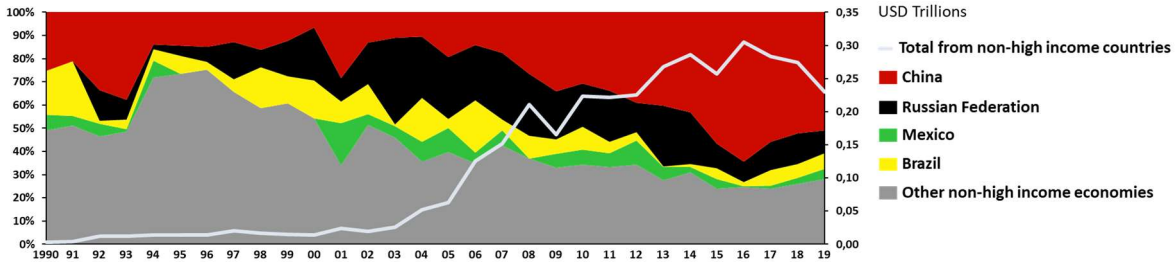
Figure 73. FDI outward stock from non-high-income countries



Source: (UNCTAD, 2020) & (World_Bank, 2020)

COFDI is >50 percent of poor countries' flow. Since 2015, COFDI sums USD 760Bn, i.e., 73 percent smaller than EU's, 29 percent smaller than USA's, and 8 percent smaller than Japan's OFDI (Figure 74).

Figure 74. FDI outflow from non-high-income countries



Source: (UNCTAD, 2020) & (World_Bank, 2020)

The seventh insight is that other top OFDI developing countries had a volatile performance since 1990. Brazil's OFDI grew until 2012 but stagnated since them. Similarly, Russia and Mexico also went up and down (Figure 74).

The eight insight is that two thirds of the IFDI stock is concentrated in the EU and the USA (Figure 75). There was an important surge of FDI inflow to the USA and the EU in 2015-2016 (driven by COFDI) but that trend was reversed since 2017 (Figure 76).

Figure 75. FDI inward stock to high-income countries

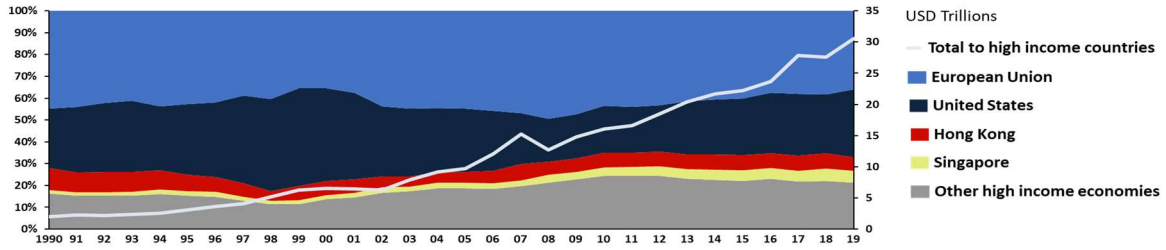
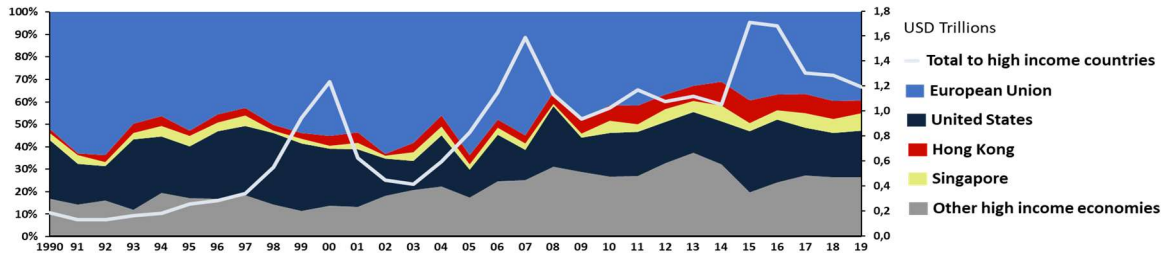


Figure 76. FDI inflow to high-income countries



Source: (UNCTAD, 2020) & (World_Bank, 2020)

It is curious to note that HK and Singapore, the other two high-income countries in the top 4 moved inversely, with HK reducing from 10 percent to 6 percent of total FDI in richer countries, and Singapore growing from 2 percent in 1990 to 6 percent in 2019.

The ninth insight is that among poor countries, China's IFDI stock is largest and grows the fastest. IFDI stock in China grew from 9 percent in 1990 to 24 percent in 2019, which is explained (figures 77 and 78) by the ability to capture a large share of the inflows to non-high-income countries (about 30 percent in the first decade vs. 25 percent in the last decade).

Figure 77. FDI inward stock to non-high-income countries

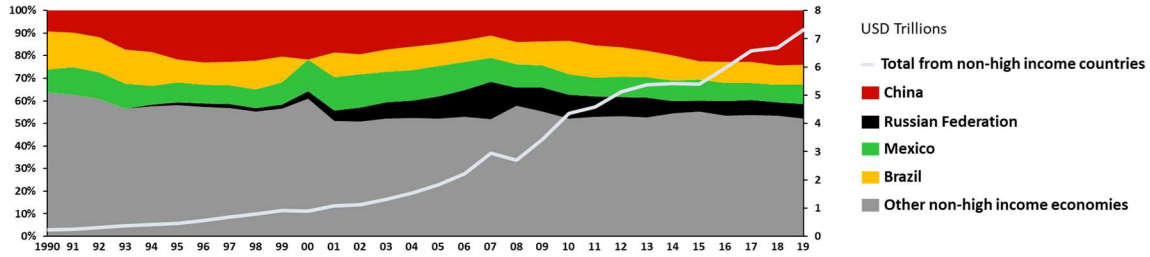
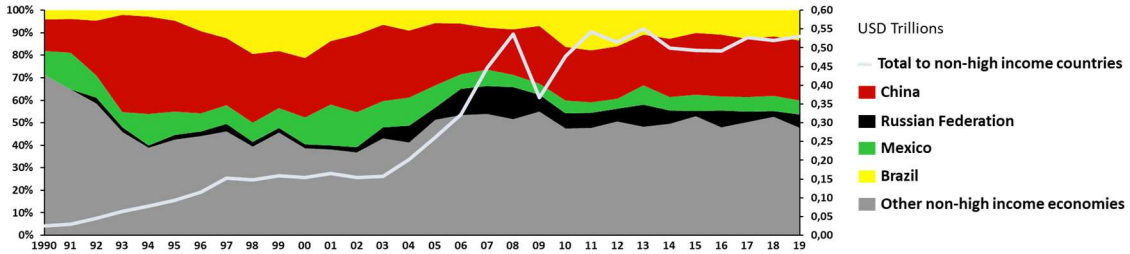


Figure 78. FDI inflow to non-high-income countries



Source: (UNCTAD, unctad.org/topic/investment/world-investment-report, 2020) & (World_Bank, 2020)

The last insight is that, if we exclude COFDI, FDI stock in non-high-income countries has remained significantly disperse with the other top 3 countries (Brazil, Mexico, and Russia) representing less than 35 percent of the remaining stock.

4.b. FDI theory and empirical research

For a time, there was the perception that FDI implied economic development: "FDI is generally considered as a factor which enhances the host country economic growth, as well as the solution to the economic problems of developing countries" (Mencinger J. , 2003). Also, FDI was presumed to be "a source of growth and economic modernization. For this reason, many governments, particularly in developing countries, give special treatment to foreign capital" (Carkovic & Levine, 2002). This is the *free-market view*, which contrasts with the opposing *marxist view* that sees FDI as imperialistic.

Although the influence of FDI on economic growth has been vastly studied, "there are still questions concerning the real effects of FDI, and also concerning the necessary conditions and the channels through which FDI leads to host country economic growth" (Moura & Forte, 2013). But some reports showed ambiguous results (Wang M. , 2009). Some see it generating economic growth, others concluded that FDI and economic growth are unconnected (Carkovic & Levine, 2002), (Alfaro, Chanda, Kalemli-Ozcanc, & Sayek, 2004), (Mencinger J. , 2003), (Kohpaiboon, 2003), (Yousaf, Nasir, Naqvi, Haider, & Bhutta, 2011). Others show it harming host country's growth (Nair-Reichert & Weinhold, 2001), (Ram & Zhang, 2002), (Bengoa & Robles, 2003), (Wang M. , 2009), (Andraz & Rodrigues, 2010), (Agrawal & Khan, 2011).

OFDI can have harmful effects at home, such as domestic job loss (Salvatore, 2012). Unemployment increases if OFDI substitutes exports, because the balance of payments may be affected (Hill, 2009). MNE "can avoid domestic monetary policies due to their access to international capital markets", which poses difficulties for governmental "control over the home country's economy" (Salvatore, 2012). It is true that "the number of studies that show positive effects is much higher than those that focus on negative effects" (Forte & Moura, 2013) but FDI has advantages and disadvantages, and its merits are higher under certain conditions.

Some authors disagree, arguing that the difficulty in proving the worthiness of FDI is explained by estimation errors (Nair-Reichert & Weinhold, 2001). Nevertheless, many studies concluded that finding the merits of FDI requires controlling for some variables. FDI effects "depend on the form of FDI: the predominance of acquisitions rather than greenfield investments explains the negative impact of FDI in economic growth" (Mencinger, 2003). For (Asheghian, 2004) what lacks is the analysis of host country domestic conditions, mostly when speaking about cross-sectional studies. (Wang M. , 2009) mentions that the difficulty comes from the use of aggregate rather than sectorial data. Many authors agree that FDI in tradable sectors is better than in non-tradable. Professor Mateus stresses that some FDI is pernicious:

> "Bhagwati's theorem called *Immiserizing growth* proves scientifically that when there is FDI oriented to a market where there is a distortion of resources, such as a monopoly, that investment will maximize its profitability by extracting rents which will cost to the economy much more than the benefit obtained from the sale". Quote from Professor Abel Mateus' interview for this thesis.

Extrapolating the experience from developed to developing countries has been misleading:

> "Data from both types of countries are often pooled into one sample, and the estimated relationships are assumed to hold equally for both types of countries. Unfortunately, these pooled coefficient estimates may significantly misrepresent the true relationship for both sets of countries." (Moran & Graham, 2005).

(Paul & Benito, 2018) created a framework for discussing FDI called Antecedents, Decisions and Outcome, or ADO: Antecedents stand for motives; Decisions stand for characteristics of FDI (such as mode of entry or growth strategy); and Outcome stands for performance or implications. This thesis uses the ADO framework. Starting with the Antecedents, it presents six important FDI theories, with special attention to those distinguishing the idiosyncrasies of developing countries. This is important because our object is the FDI from a developing country (China) into a developed country (Portugal). The first three theories are older and more generic, and the last three are more recent and attempt to explain FDI from emerging economies.

The **Internalization theory** is a contribution from (Hymer, 1976) even if (Rugman, 1980) followed up with the inclusion of internationalization logics. It explains FDI motivations based on home-country firm-specific advantages instead of local factor endowments in the foreign market (Verbeke & Kano, 2016). (Hennart, 1986) extended it to vertical/horizontal integration. Dunning is the legend in FDI scholarship and his **eclectic** or **OLI paradigm** theory (Dunning J. H., 1988) (Dunning J. H., 2000) is the most used in FDI research (Paul & Feliciano-Cestero, 2020). It investigates how firms leverage ownership (O), location (L), and internalization (I) advantages to compete abroad. (Dunning J. H., 2006) acknowledged that this model needed a revision to incorporate emerging markets multinational enterprises (EMNE) specificities and the idiosyncrasies of new-generation firms (e.g., big tech companies). He also created one of the most used categorization of FDI motives, arguing that FDI is divisible in four groups, in line with what the investor seeks: natural resources, market, efficiency or strategic assets.

Natural resource seeking FDI aims to "secure stable, low-cost and high-quality supply of natural resources, such as minerals, oil and gas or agricultural products" (Meyer, 2015). The main goal is to invest abroad to get resources, which are not available at home, or to get them cheaper (Dunning J. H., 1993). These include physical resources but also cheap labor, technology, information and managerial skills.

M**arket seeking FDI** aims to "sustain or protect existing markets (by circumventing trade barriers), or to exploit or promote new markets, typically in the host country" (Meyer, 2015). This FDI is usually held to supply goods and services in the target country or third countries associated with it. It can include the establishment of production facilities or focus on learning about the local market preferences, requirements and business/investment practices.

E**fficiency seeking FDI** aims to reduce costs, generally through "economies of scale and scope, logistics infrastructure, and risk diversification" (Meyer, 2015). It is mostly performed by MNE with cross-border investment experience (Dunning J. H., 1993).

S**trategic asset seeking FDI** aims "to enhance the capabilities of the acquiring firm in view of long-term competitiveness in home and third-country markets" (Meyer, 2015). Strategic assets comprise marketing skills, technology, management, organizational systems, and innovation capacity which can improve the investor's competitive position abroad (Dunning J. H., 1993).

It is important to note that these four motives are all business motives. Potential political motivations, which are discussed in this thesis, do not fit this framework.

The third is the **product lifecycle theory** (Vernon, 1966), which suggests that in a product's lifecycle everything about its creation comes from home. After, the product is used in international markets and its production moves abroad. The cycle had four steps: innovation, growth, maturity, and decline. Sometimes the product ends up being imported back home.

The **Linkage Leverage Learning** theory explains how latecomer firms challenge established global competitors. It is gaining attention due to its relevance in explaining the motivations and operationalization of EMNE's OFDI into developed countries. EMNE involve themselves in OFDI to emerging countries and then to developed markets, evidencing catch-up strategies (Paul & Feliciano-Cestero, 2020). It focuses on FDI-powered mechanisms for technologically lagging companies to upgrade themselves through active knowledge absorption and learning.

The **Springboard model** (Luo & Tung, 2007) clarifies the international expansion motives, behaviors, and processes of EMNE. The core of this theory is how EMNE use international expansion to acquire the relevant resources to compete in the home country markets with foreign MNE from developed countries (Paul & Feliciano-Cestero, 2020).

The **CAGE distance framework** (Ghemawat, 2001) applies to all countries, and identifies the Cultural, Administrative, Geographic, and Economic differences (or *distances)* that enterprises should consider in their international strategies. Distance introduces hidden costs which are underestimated by MNEs. It provides interesting insights but is not extensively used.

We move now to the Decisions (the "D" in ADO), which refer to where and how FDI takes place. Since the 2000s, IPE scholars have been exploring two FDI topics: (1) how the quality of the host country institutions affects destination selections, and (2) the proliferation of investment treaties, FDI promotion policies and their impact on destination choices. Regarding (1), "the single most-studied research question about the politics of FDI in the last two decades concerns the types of political regimes MNE prefer for the countries in which they invest […] democracies tend to receive more FDI, but scholars disagree why." (Pandya S. , 2016). It also seems that MNE privilege destinations which protect property rights, but sometimes IP protection does not go together with protection from expropriation for distributive purposes (Li & Resnick, 2003). Regarding (2), "over the past 20 years, countries increasingly swapped FDI restrictions for FDI incentives" (Pandya S. , 2016), despite the doubts about the distributive consequences of FDI.

A third topic gaining attention is the relationship between corruption and destination decisions. Corruption can impact in two ways. First, it influences the costs for MNE to doing business in the host country. Second, corruption shapes skills in one location and those skills can help in an equivalent environment. This transfer of practices can happen from the home country to the destination but also from the destination back home or to a third country. That said, less corruption generally leads to attraction of more FDI (Brada, Drabek, Mendez, & Perez, 2018). FDI is linked to corruption in developing countries and under authoritarian regimes because it is usually related to the opportunity of extracting rents (Pinto & Zhu, 2013).

A fourth topic is the relationship between FDI and trade, which "are different manifestations of global production. International trade is the cross-border flow of goods and services, whereas FDI is the cross-border flow of the ability to produce goods and services." (Pandya S. , 2016).

It has been demonstrated that goods and services requiring articulation with consumers are more prone to be produced at the destination (Oldenski, 2012) and market-seeking FDI has been proven to affect more exports that other types of FDI (Franco, 2013).

A fifth topic is the impact of bilateral ties on ownership choices. The internalization theory surfaces that "weak economic, political and military relationships between acquiring and target countries induce EME to opt for full acquisitions" (Yoon, Peillex, & Buckley, 2020). China is closer to Japan than to the UK (in CAGE distance) but "Chinese firms may prefer or be more welcome to invest in the UK […] due to the favorable and friendly bilateral relationship".

In terms of Outcomes, the *neoclassic growth theory* proposes that GDP "is a function of labor and capital, (while) technology is considered as an exogenous factor" (Barro & Sala-i-Martin, 1995). In that case, "inward FDI is a driving force of growth as it increases capital accumulation in the host country. However, it only has a short-run effect on economic growth" (Ericsson & Irandoust, 2001). The alternative *Endogenous growth* theory highlights "the importance of knowledge and technology in the economic growth process and postulates that technological change is an endogenous determinant of economic growth" (Barro & Sala-i-Martin, 1995). The long-term impact of FDI on growth comes from capital accumulation and innovation.

FDI increases competition: the arrival of foreigners encourages locals to safeguard their profits, leading to "severe competition, low price, wide consumer choice and high-quality standards in the host country" (Zang & Maimbridge, 2014). Locals improve efficiency and innovation, develop new products and upgrade technologies, reproducing the technology brought by IFDI and copying their practices. IFDI generates technological spillovers both forward (to customers) and backwards (to suppliers) and human capital spillovers "in the host country by introducing the host country management practices, organizational and marketing techniques". The know-how is "transferred to the host country as domestic employees move from foreign to local firms or set up their own businesses" (Zang & Maimbridge, 2014). Other impacts include increased

employment and the improvement of resource allocation (i.e., specialization) via the concentration of "economic activities where the host country has a comparative advantage" (Zang & Maimbridge, 2014). Finally, "IFDI improves the balance of payments in the host country if IFDI and imports are substitutes" (Hill, 2009).

EMNE seem to be different from MNE from developed countries across all three letters of ADO. First, their firm-specific advantages (FSA) are different, and they invest abroad not only to exploit their FSA but also to acquire some. Meyer identified five typical FSA from EMNE: (1) those related to natural resources, (2) marketing and distribution capabilities derived from uniquely massive customers bases, (3) operational capabilities in labor intensive manufacturing processes with large scale, (4) institutional know-how such as managing under institutional void, and (5) political capabilities such as ties with Government officials providing preferential access to contracts of diplomatic endorsement. He also surfaces some gaps that need to be filled by EMNE. These include technology and brands but also managerial skills and distribution networks. Because of that "they can accelerate their internationalization by acquiring firms abroad that control strategic assets" (Meyer, 2018).

Meyer singles out the exposure to political interests and pressure as a feature more prevalent in EMNE. These state-related firms have preferential access to resources such as "guarantees, bank loans, information about foreign business environment, as well as collaboration with research institutes and universities" (Meyer, 2018). This dependence generates alignment with governmental goals. Time has raised the level of concern in developed economies about FDI from EMNE, which in turn has legitimated a protectionist drift, even if "the processes by which ties to political actors – through ownership or through personal relationships – influence firm-level actions are not well understood" (Meyer, 2018).

There are, nevertheless, several attempts to shed light into this topic. One of these attempts has integrated a resource-based view (to whom internationalization decisions are economically

driven) with an institutional view (to whom "such decisions are the outcome of isomorphic pressures and political influences") and concluded that

> "government involvement is associated with various institutional pressures and benefits that influence the ability and willingness of EMNE to internationalize by: (1) helping firms overcome information, transaction cost and resource constraints and (2) influencing the strategic objectives and decisions of managers, and the way in which they allocate firm resources.*"* (Wang, Hong, Kafouros, & Wright, 2012).

The effect of Government on FDI "depends upon the contingencies associated with the firm's own capabilities and resource position, the type of involvement, and the location and type of OFDI". While involvement through "state ownership plays a more important role in stimulating resource-seeking OFDI, affiliation with higher government levels more likely leads to market-seeking investment [… (and)] to developed markets" (Meyer, 2018).

State-owned MNE differ from private MNE: objectives go beyond profit maximization, resources are more easily accessed, and strategies are more explorative than exploitative (Clegg, Voss, & Tardios, 2018). Developed countries (e.g., Norway, France) are also active in the internationalization of their SOE, but autocracies are more intrusive in determining their objectives abroad. When SOE expand abroad, independently from their domestic political regime, they are not trying to correct a market distortion as it is typically the case at home: the rationale is to raise the welfare of *the home country* (Clegg, Voss, & Tardios, 2018). Those authors argue that autocracies are more likely to foster the internationalization of their SOE and do so with a mercantilist mindset and through acquisitions, rather than greenfield.

Some researchers have addressed the plausibility that Government goals may steer some FDI flows (particularly in autocracies, but not only there) but it is striking that the mainstream theories of FDI do not attempt to explain its political or strategic implications. Contributions to the topic are scarce but valuable. Already in 2012, some authors called for the attention of Government backed investments from EMNE. They explained that these are performed by

SOEs and Sovereign Wealth Funds[8] (SWF). The difference between them is that SOE are mostly capitalized by their operations (despite their privileged financing), whereas SWF manage assets typically generated from oil and gas revenues (60 percent in 2012), export earnings (e.g., commodities) and financial holdings. The main concerns about state-related FDI regard the security threat of allowing "foreign access to sensitive technology or of foreign control over natural resources, key industrial complexes or critical infrastructure. There are of course also various grey areas, for example, where an attempted M&A involves a national champion". The authors emphasize the simultaneity of some key features: "policy makers remain especially concerned about the possibility of a political bias in investments made and managed by state-controlled entities in strategic or sensitive industries, especially when they take the form of M&A." (Sauvant, Sachs, & Jongbloed, 2012). This concern is an alert regarding an investment profile which can pose a threat to any given nation. The question that remains is Why is it threatening to receive state-related M&A FDI in sensitive industries?

Kim & Milner wrote a document which tackles the scarcity of studies that examine political activities and political influence of MNEs in the USA. MNEs are only 1 percent of USA firms but represent 25 percent of private GDP and private employment, and 50 percent of American exports. The same happens at a global level, with MNCs representing 50 percent of global exports and 28 percent of GDP. MNE's "economic dominance reduces the relative cost of engaging in political activities, while their large-scale transnational activities increase the marginal benefits of influencing policy-making individually" (Kim & Milner, 2020). They focus on the first of Nye's three channels used by firms to exert their influence over policy making: (1) direct influence through lobbying, (2) indirect influence as an instrument of the state, and (3) unintended influence via agenda-setting. They show that MNE spend more in

8 Sovereign Wealth investments can be understood in a continuum which goes from Central Bank and Foreign Exchange Funds to Stabilization Funds, Pension and Social Security Funds, Domestic development Funds, Sovereign Wealth Funds to SOE.

lobbying than on campaign financing, but they finance political campaigns more than similar size domestic firms. They refer that "informal lobbying and connections, illegal bribery, threats of exit or promises of new deployment, campaign contributions and PAC are additional interrelated matters which need to be assessed altogether" (Kim & Milner, 2020). About MNE being able to convert their resources into political influence it is said that "our data cannot give a direct answer. But the direction of the USA foreign economic policy in the past decades suggests they have been very powerful" (Kim & Milner, 2020). They cite Lee', who argues that US subsidiaries of foreign firms are "more politically active than similarly sized American firms" and that "this greater political intensity is driven by the desire of the foreign parents to gain political leverage in domestic politics, rather than the local subsidiaries' need to protect investment against political risk" (Lee, 2018). Lee coins the term *political foreign investment* to describe firms utilizing subsidiaries as their political agents abroad. He focuses on campaign financing and shows that foreigners contribute proportionally more than locals. But proving that foreign firms invest in political influence does not mean that their involvement should be forbidden (which happens in many countries). For him, it is "imprudent for policymakers to make it more difficult for foreign firms to engage in domestic politics, especially when economic integration is inevitably merging interests across-borders" (Lee, 2018).

COFDI is at the center of the FDI debate because of its growing relevance and because it surfaces limitations of the existing theories: it presents "an opportunity for the development of theory, not just to explain what is new, but to better explain what we think we already know". What exists is insufficient – the LLL model is "more of a description rather than an explanation". It incorporates the theories of knowledge transfer and diffusion, positive spillovers but is incomplete. COFDI takes away a veil which prevented the academia from seeing the influence of governments in directing, enabling, and taking advantage of MNE activities. For them, "COFDI in the EU is the ideal nursery for theory" (Clegg & Voss, 2018).

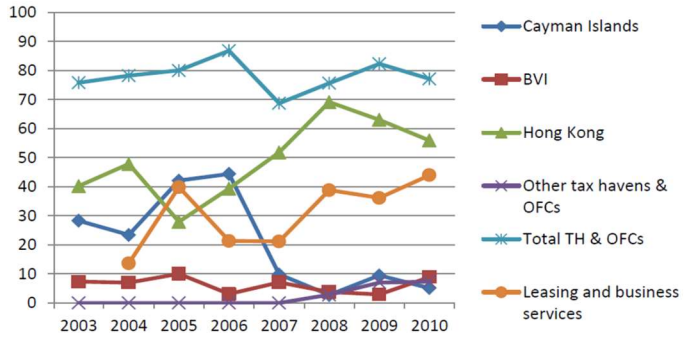
4.c. COFDI quantification and its determinants

4.c.i. Selection of COFDI data sources

That FDI flows are hard to quantify, particularly on a bilateral (origin-destination) level. A critical problem resides in the flows through opaque financial centers and tax heavens (TH). Using COFDI in Portugal as an example, we can estimate the FDI inflow to Portugal and the FDI outflow from China using multi-country databases. But we cannot calculate the flow from China to Portugal because the capital flows from China through intermediate countries, such as the British Virgin Islands (BVI), HK, LX, NL or Malta, before arriving in Portugal. The China-Portugal flow shows up as two (or more) irreconcilable flows – China investing in the intermediary and the intermediary investing in Portugal: "Serious methodological shortcomings plague empirical studies in these disciplines. Specifically, the vital issue of how Chinese MNEs use and route FDI via tax havens and offshore financial centres is not adequately dealt with" (Sutherland & Anderson, 2015).

The Chinese Ministry of Commerce (MOFCOM) shows that ~80 percent of COFDI flows through TH and Other Financial Centers (OFCs), namely Cayman, BVI and HK (Figure 79).

Figure 79. Geographical breakdown of OFDI (2003-2010)



Source: (Sutherland & Anderson, 2015), based on MOFCOM

This is a global phenomenon, not Chinese specific. As Figure 80 shows, 90 percent of the companies listed in the PSI-20 (Portugal's stock market) are headquartered in NL, where they distributed over EUR 2.2 Bn of dividends in 2019.

Figure 80. PSI-20 companies headquartered in the Netherlands

PSI20	Holding Holandesa	Dividendos 2019* (Milhões €)
altri	Cofina BV	148
Millennium bcp	BCP Investment BV	30
AMORIM	Amorim Benelux BV	25
edp	EDP Finance BV	695
edp renováveis	EDP Finance BV	61
galp	Galp Energia E&P BV;Windhoek PEL 23 BV	522
Jerónimo Martins	New World Investments BV	205
MOTA-ENGIL	Flame Investments BV	14
NOS	Teliz Holding BV	143
NOVABASE	Nbase International Investments BV	5
PHAROL	BRATEL BV	###
REN	REN Finance BV	114
Semapa	Seinpar Investments BV	41
SONAE	Soflorin BV , Sonvecap BV, Sontel BV, Sonae Investments BV	93
SONAE CAPITAL	SC Finance BV	15
NAVIGATOR	Seinpar Investments BV	99

Source: (Esquerda.net, 2020)

There is no single accurate source of COFDI quantification and the US, the EU and the WB are trying to overcome that challenge. Meanwhile, the main available sources are:

- **CGIT**, published by the American Enterprise Institute (AEI) and the Heritage Foundation since 2005, is the only comprehensive public dataset of COFDI. Includes 3,500 transactions (all above USD 100 Mn). It sums investments announcements, so it does not estimate stocks, or net flows. When calculating *stock* with this source we use stock 0 in 2004, and 0 divestments thereafter. It only estimates OFDI from China.

- **Finflow,** published by the EC since 2017, includes 41 EU/OECD countries, 18 offshores, and 25 others (including China). It is still unreliable, so it is not used here. Figure 81 illustrates the insufficiency of its estimates for Portugal.

Figure 81. Problematic Finflow data for COFDI in Portugal

Inflow FDI Portugal	2011	2012	2013	2014
World	7 653	16 168	11 303	9 963
errors/ not allocated	10 121	9 020	3 921	- 8 513

the amount classified as "not allocated/ errors" is far from negligible

Source: By the author, using Finflow database

Finflow uses bilateral data from ***OECD*** and ***Eurostat*** (for non-OECD countries), cross-checked with **IMF Coordinated Direct Investment Survey** and the **UNCTAD**. IMF is a good source, but only publishes COFDI data for 2018. ***OECD's*** *International Direct Investment Statistics* focuses on OECD (China is not a member) but estimates total stock and flows for all G20 countries, including China.

- **UNCTAD**'s *World Investment Report* estimates stock and flow for many countries but not bilaterally, therefore we cannot extract COFDI estimates in specific countries.
- **MOFCOM** publishes the Statistical Bulletin of COFDI. Amounts are underestimated because it only includes government-approved deals. In 2020, MOFCOM, the Chinese State Administration of Foreign Exchange (SAFE) and the Chinese National Bureau of Statistics jointly issued the Annual Statistical Communiqué of COFDI 2019. SAFE publishes separate COFDI estimates since 2004.
- **Rhodium** partners with MERICS explore investment patterns in Europe and produce the Cross Border Monitor for the EC under the "China Observatory" project and provides valuable breakdowns of COFDI in the EU.
- **WB** uses IMF Balance of Payments data, **UNCTAD** and national sources. It provides flow data but not the stock, which is presented in net terms.

In 2020, the American Congress issued a report about COFDI data challenges, which raises the awareness about the inaccuracy of COFDI data, and the reasons behind that:

> "(there is a) critical gap in the availability and accuracy of data and information. Most notable is the fact that no comprehensive, standardized, or authoritative data from either the Chinese Government or international organizations are available on Chinese overseas economic activities. Given the complexity and multifaceted nature of the projects in which Chinese entities are involved, attempts to assess the size and scope of these projects are rough estimates, at best, and should be regarded as such." (Schwarzenberg, 2020).

It points out five issues with COFDI: (1) MOFCOM statistics only include projects approved by the Government; (2) Chinese definitions of what constitutes an investment changed over time; (3) many datasets ignore projects below certain thresholds; (4) +75 percent of COFDI goes through offshores; and (5) many databases record amounts at announcement date and ignore future changes. It compares the multiple sources and highlights discrepancies (figures 82-83).

Figure 82. China's total COFDI flows

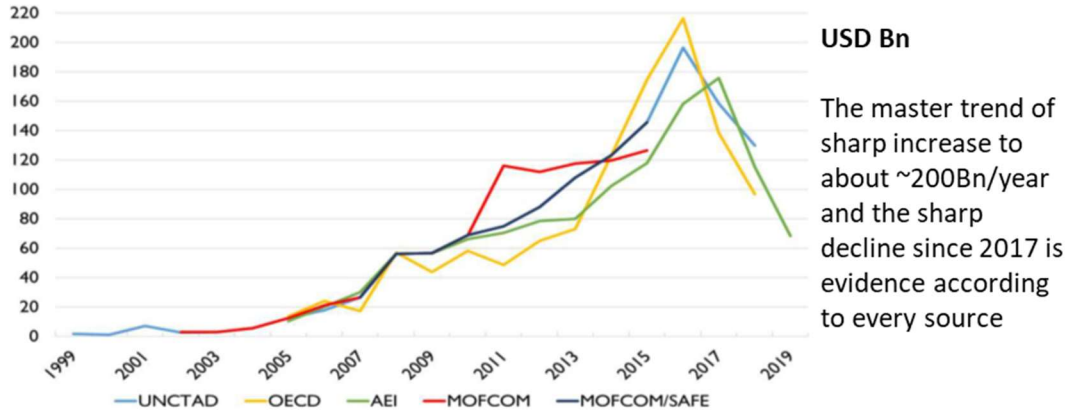
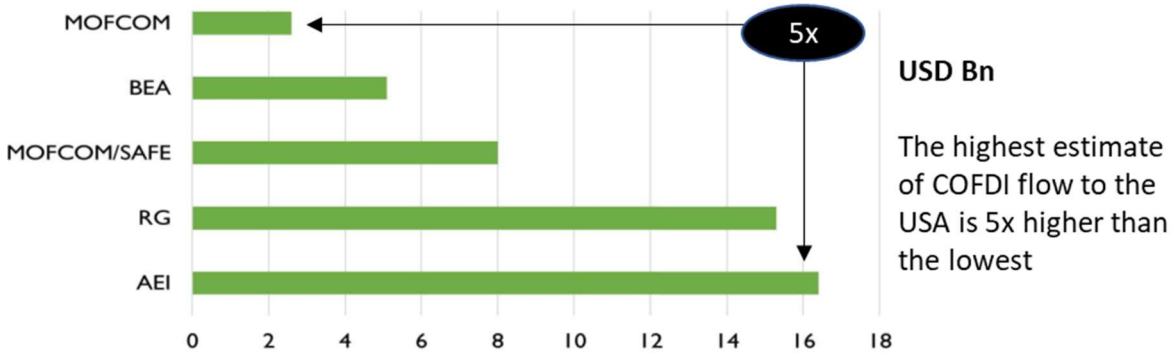


Figure 83. China's FDI Outflows to the USA in 2015



Source: (Schwarzenberg, 2020)

The problem with using international reporting standards (EUROSTAT-ESA2010, IMF-BPM6 and OECD7BMD4) for tracking FDI is that they miss the ultimate investor, only requesting recording the declaring country and the first reporting country. The EC confirms that it is not appropriate to use national accounts for describing FDI in the EU:

> "if we were to use bilateral FDI to analyze foreign investments, we would have two options: use either EU countries declarations of the domestic assets hold by foreigners or use foreign countries declarations on the assets they hold in Europe. These two declarations usually do not coincide." (EC, 2019).

The EU is tackling the challenge by developing proprietary databases: the mentioned Finflow, and FOWN[9] (a firm-level base using Bureau Van Dijk).

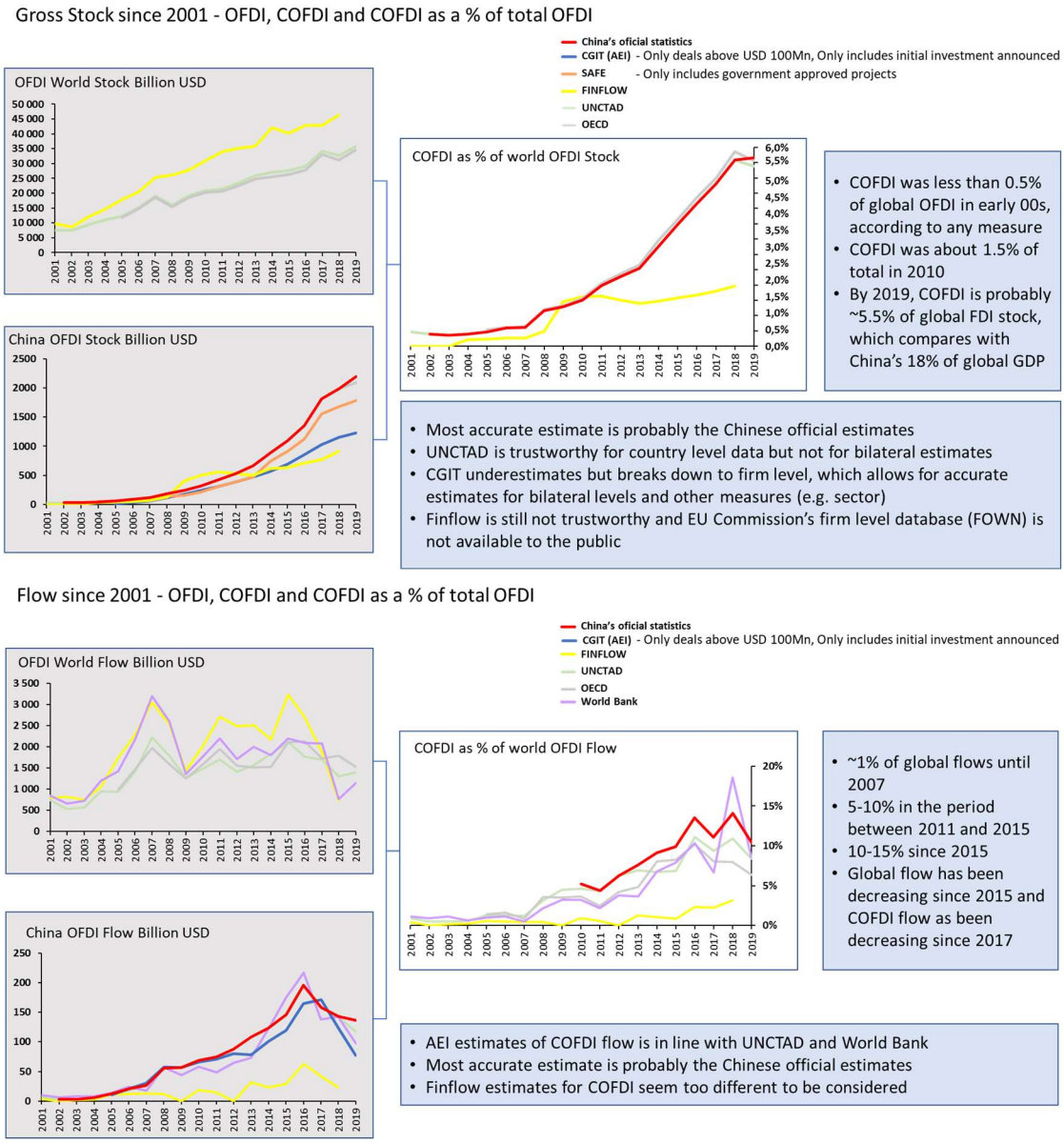
The WB published a policy paper analyzing COFDI which concludes that "the main sources of FDI data used are UNCTAD's bilateral FDI flow database and China Global Investment Tracker" (Chen & Lin, 2018). The author of this thesis has compared all relevant OFDI and COFDI estimates available and agrees that UNCTAD is the preferred source for top-down information and CGIT is the main firm-level source.

9 Unfortunately, the managers of the FOWN database refused to share it with the author of this thesis.

4.c.ii. COFDI quantification in the world

Figure 84 compares the available sources of COFDI stock and flows. COFDI was < 0.5 percent of global stock until 2005 and grew faster than the world since then, reaching 1.5 percent in 2010 and ~5 percent by 2019. It is still far from China's ~18 percent share of global GDP.

Figure 84. COFDI stock and flows since 2001

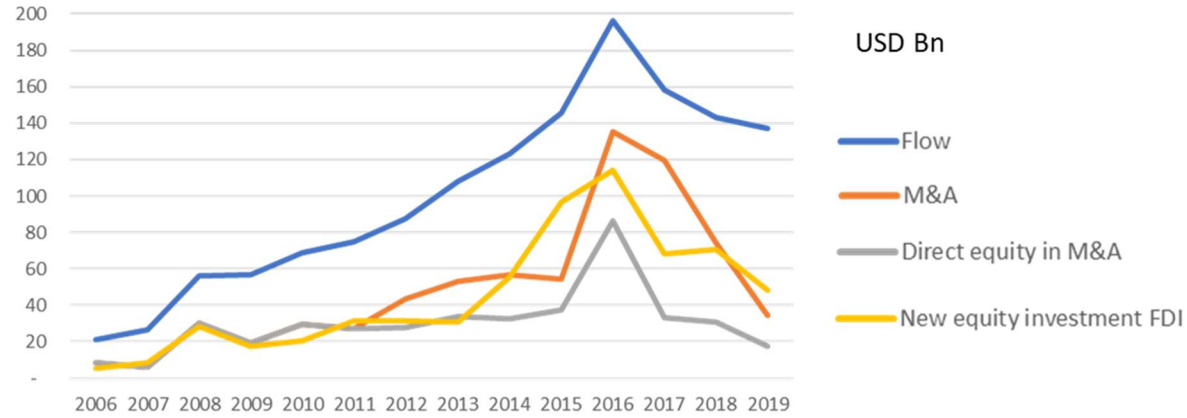


Source: By the author using CGIT, Finflow, UNCTAD, OECD

The COFDI flow escalated furiously since 2005. It was ~1 percent of global flows until 2007, but already 5-10 percent between 2011 and 2015, and 10-15 percent since 2015. It is important to note that the global FDI flow decreased since 2015, and COFDI flow decreased since 2017.

The Chinese official *2019 Statistical Bulletin* details the evolution of four correlated but distinct variables (Figure 85). In blue we have the COFDI flow, in orange the amount of Chinese M&A overseas, in grey the domestic equity or debt component of the M&A deals overseas (i.e., excludes foreign financing), and in yellow the new equity component of the FDI flow (i.e., excludes the reinvested earnings and the debt instrument investment).

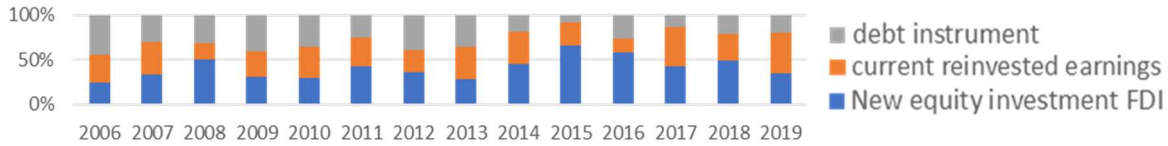
Figure 85. Chinese FDI flows vs. M&A and equity investments



Source: (MOFCOM, NBS, & SAFE, 2020)

The fact that until 2017 the direct equity in M&A (grey line) grows the least shows that (1) China is increasingly financing its M&A with foreign debt, (2) the share of greenfield investments is growing, and (3) that new investment is decreasing its share compared to the reinvested earnings (see also Figure 86 which confirms it).

Figure 86. FDI breakdown by component



Source: (MOFCOM, NBS, & SAFE, 2020)

In terms of geography, Europe has been the largest recipient of COFDI (Figure 87). It ranked first in the period 2005-2014 (total of USD ~110Bn) and the annual flow increased four times since 2015, totaling USD ~260Bn in 5 years. The UK and Switzerland concentrate ~40 percent of the COFDI flow to Europe, which reduced significantly since 2017.

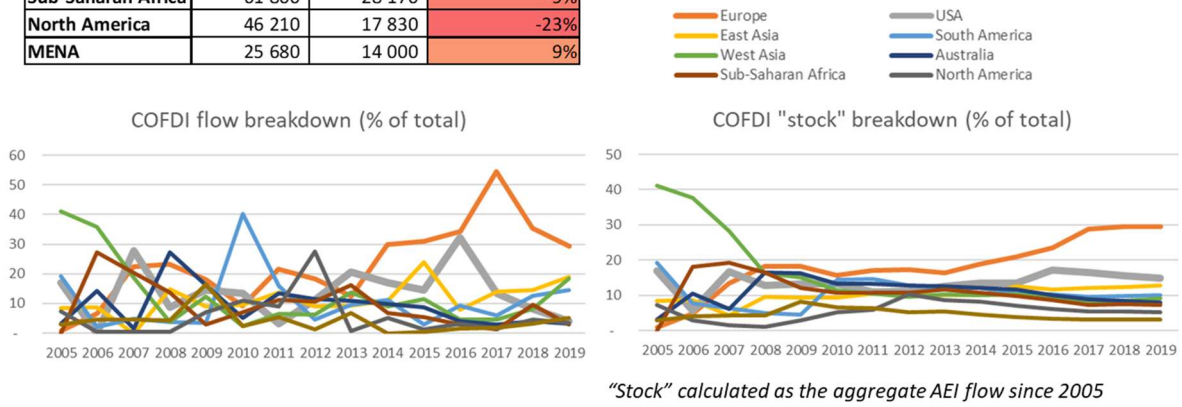
Figure 87. COFDI geographical breakdown since 2005

AEI USD Millions

Region	2005 to 2014	2015 to 2019	Avg. year growth
Europe	107 380	256 090	377%
USA	76 500	106 990	180%
East Asia	57 880	101 460	251%
South America	68 450	56 850	66%
West Asia	57 290	54 890	92%
Australia	69 080	29 840	-14%
Sub-Saharan Africa	61 800	28 170	-9%
North America	46 210	17 830	-23%
MENA	25 680	14 000	9%

Main insights

- Europe is the largest and fastest growing recipient region of COFDI (the UK and Switzerland account for 40%)
- East Asia grew fast (driven by Singapore, Japan, Malaysia and Indonesia)
- Australia and Canada saw the main reductions in the last 5 years, but Africa also declined
- Sharp drop of COFDI in the USA and in the EU since 2017



"Stock" calculated as the aggregate AEI flow since 2005

Source: By the author, using CGIT database

COFDI flows to East Asia have grown fast, mostly driven by flows to Singapore, Japan, Malaysia, and Indonesia. Australia and Canada have reduced the most in COFDI inflows, while Sub-Saharan Africa witnessed a decline of 9% of the average annual COFDI flow.

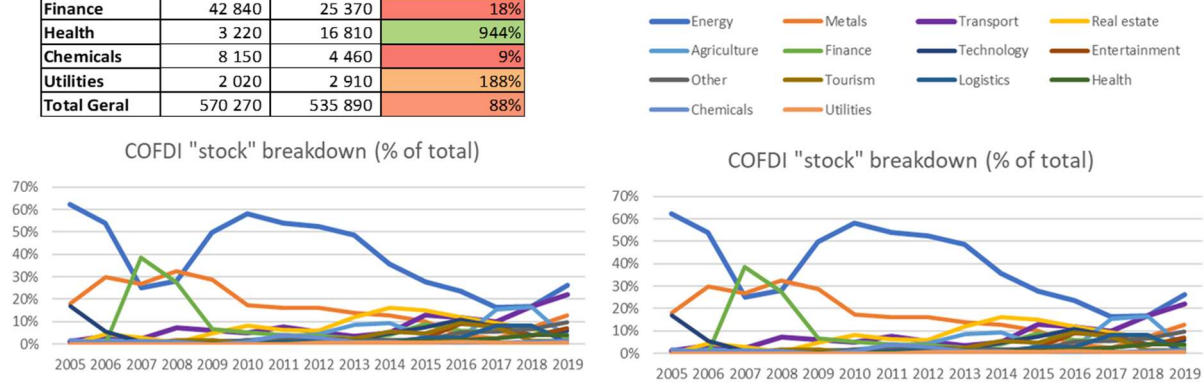
Figure 88. COFDI sectorial decomposition since 2005

AEI USD Millions

Sector	2005 to 2014	2015 to 2019	Avg. year growth
Energy	255 310	107 540	-16%
Transport	30 790	77 040	400%
Agriculture	26 020	56 340	333%
Entertainment	6 130	42 430	1284%
Technology	16 320	38 320	370%
Real estate	49 840	37 610	51%
Other	7 920	37 110	837%
Metals	106 180	33 630	-37%
Logistics	3 500	28 330	1519%
Tourism	12 030	27 990	365%
Finance	42 840	25 370	18%
Health	3 220	16 810	944%
Chemicals	8 150	4 460	9%
Utilities	2 020	2 910	188%
Total Geral	570 270	535 890	88%

Main insights

- Despite 16% decrease of annual flow, Energy remains the dominant sector for COFDI
- Metals drop 37% which means moving from 2nd largest to midsize
- Largest growth happens in Transport and Logistics, Technology, Healthcare, Entertainment and Tourism
- Real Estate and Finance grow, but less than average



"Stock" calculated as the aggregate AEI flow since 2005

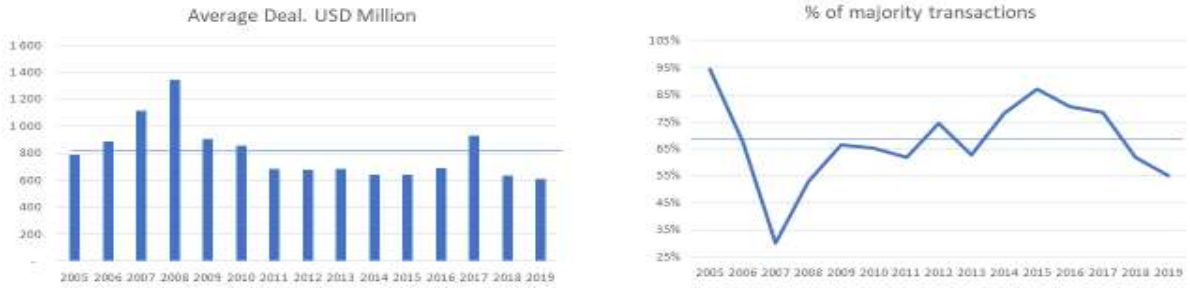
Source: By the author, using CGIT database

In terms of sectors, Figure 88 shows that despite a 16 percent decrease in annual flows, energy remained first sector for COFDI with USD ~20 Bn/year. Metals, which was second between 2005-2014, dropped 37 percent since 2015. The fastest growing sectors were transport & logistics (associated with the BRI), technology, healthcare, entertainment, and tourism. RE and finance grew but below average (~88 percent).

The Chinese official figures provide a different breakdown. According to the 2019 Statistical Bulletin the *leasing and business services* sector "topped the list with USD 738Bn, accounting for 33% of China's OFDI stock, including foreign investment activities focusing on investment holding, which were mainly distributed in HK (China), the BVI, the Cayman Islands" (MOFCOM, NBS, & SAFE, 2020). The other sectors, which sum USD >100 Bn, are wholesale and retail, trade, finance, information transmission software and information technology services, manufacturing, and mining. Energy is absent, contrasting with its first place in CGIT.

The average deal size (of those above USD 100 Mn) decreased in the last 15 years, averaging USD ~900 Mn in the first half of the period, and USD ~700 Mn in the second half (Figure 89).

Figure 89. Average deal profile of global COFDI



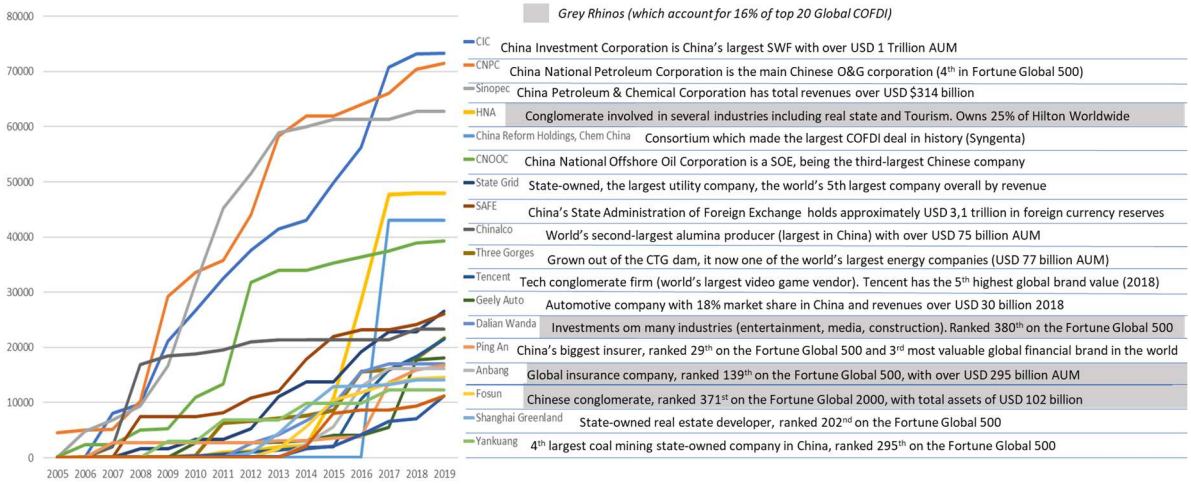
Source: By the author, using CGIT database

The proportion of majority acquisitions has oscillated, averaging 70 percent. There is a downward trend since 2015, reaching only 55 percent in 2019.

The top 20 investors concentrate 48 percent of global COFDI since 2005 (Figure 90). Among them there are four *grey rhinos*, a term coined by Xi Jinping in 2018: "be on guard against black swans and keep watchful for grey rhinos" (警惕黑天鹅, 防范灰犀牛) (People's_Daily, 2019). *Grey*

rhinos are *private* conglomerates which were selected as spearheads to purchase controlling stakes in Western strategic assets unavailable to Chinese SOE. Some have grown out of control and were eventually stopped. They sum 16 percent of COFDI by the top 20 COFDI investors.

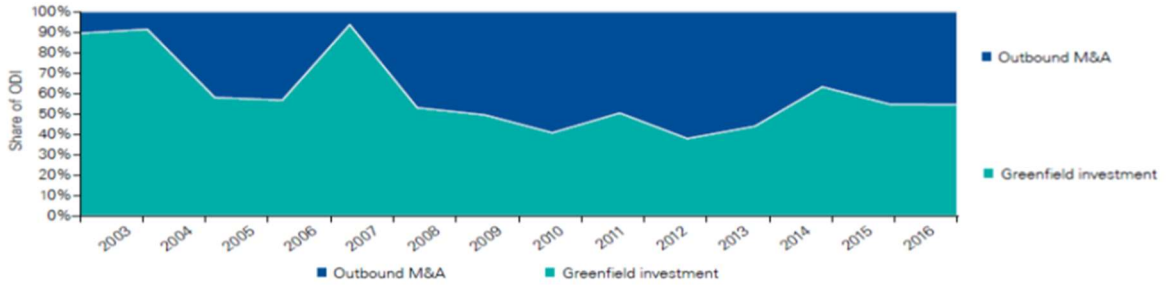
Figure 90. Stock of COFDI of top 20 Chinese Investors



Source: By the author, using CGIT database and company's websites

The percentage of greenfield (vs. M&A) is stable around 50-60 percent since the financial crisis (Figure 91).

Figure 91. COFDI M&A vs. Greenfield as % of global COFDI



Source: (KPMG, 2018)

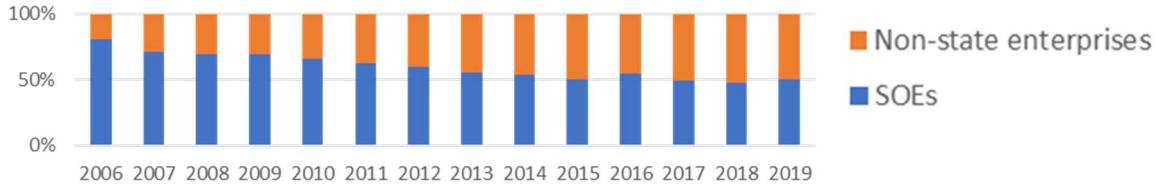
It is important to notice that the mix differs depending on the governance environment of the host country. A study of 152 Chinese MNE with 401 subsidiaries distributed in 26 countries, from 2003 to 2013, found that greenfield investments are preferred over acquisitions in relation-based host markets, and M&A are preferred in rule-based countries. Moreover,

> "the depth of Chinese EMNEs' international experience (i.e., the amount of previous investments in the same host market) moderates the effect of the governance

environment on the establishment mode. Firms with greater international depth use more M&As in relation-based markets and more greenfield investments in rule-based markets, suggesting that previous investments in the same host country provide a type of learning that reduces acquisition uncertainty in the former case and increases the self-confidence of Chinese EMNEs in the latter." (Alon, Elia, & Li, 2020).

The proportion of COFDI performed by SOE is decreasing (Figure 92).

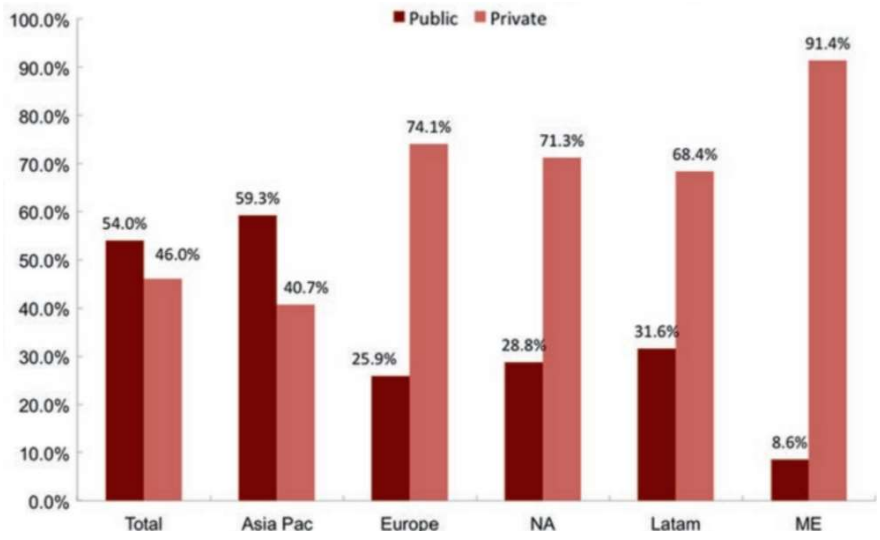
Figure 92. SOE vs. Private capital as % of global COFDI



Source: (MOFCOM, NBS, & SAFE, 2020)

The proportion of SOE vs. private COFDI also depends on the host country. Collier confirms that private COFDI accounts to ~55 percent, but SOE prevail in Asia-Pacific (Figure 93).

Figure 93. COFDI transactions by ownership (2017)



Source: (Collier, 2018), based on Bloomberg data

It is hard, and too early, to assess the financial performance of COFDI. Nevertheless, there is a study by McKinsey & Co. (2017), which analyses 505 deals (USD 430Bn) with publicly available information and reaches three conclusions. The first is that in 84 percent of the deals (89 percent of value) there was no value creation for the acquirer, losing ~10 percent of the investment (Figure 94). The second is that the level of control matters – – 34 percent of the

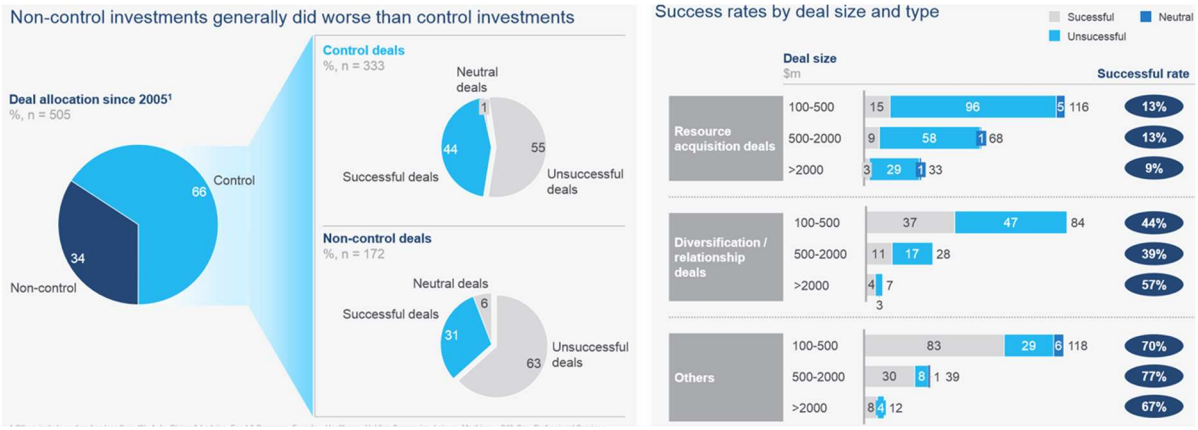
deals were non-control investments, from which ~30 percent were successful. For the investments with control, the success rate rises to 45 percent (Figure 95). The success is lower in resource seeking deals (~12 percent).

These reveal that there is something intrinsically different in the Chinese valuation methods and/or assumptions. Most likely a lower time value of money (i.e., the Chinese discount rate) and valuing the target's intangibles as scarcer.

Figure 94. Estimated financial returns of COFDI in public companies



Figure 95. Rate of success of COFDI deals

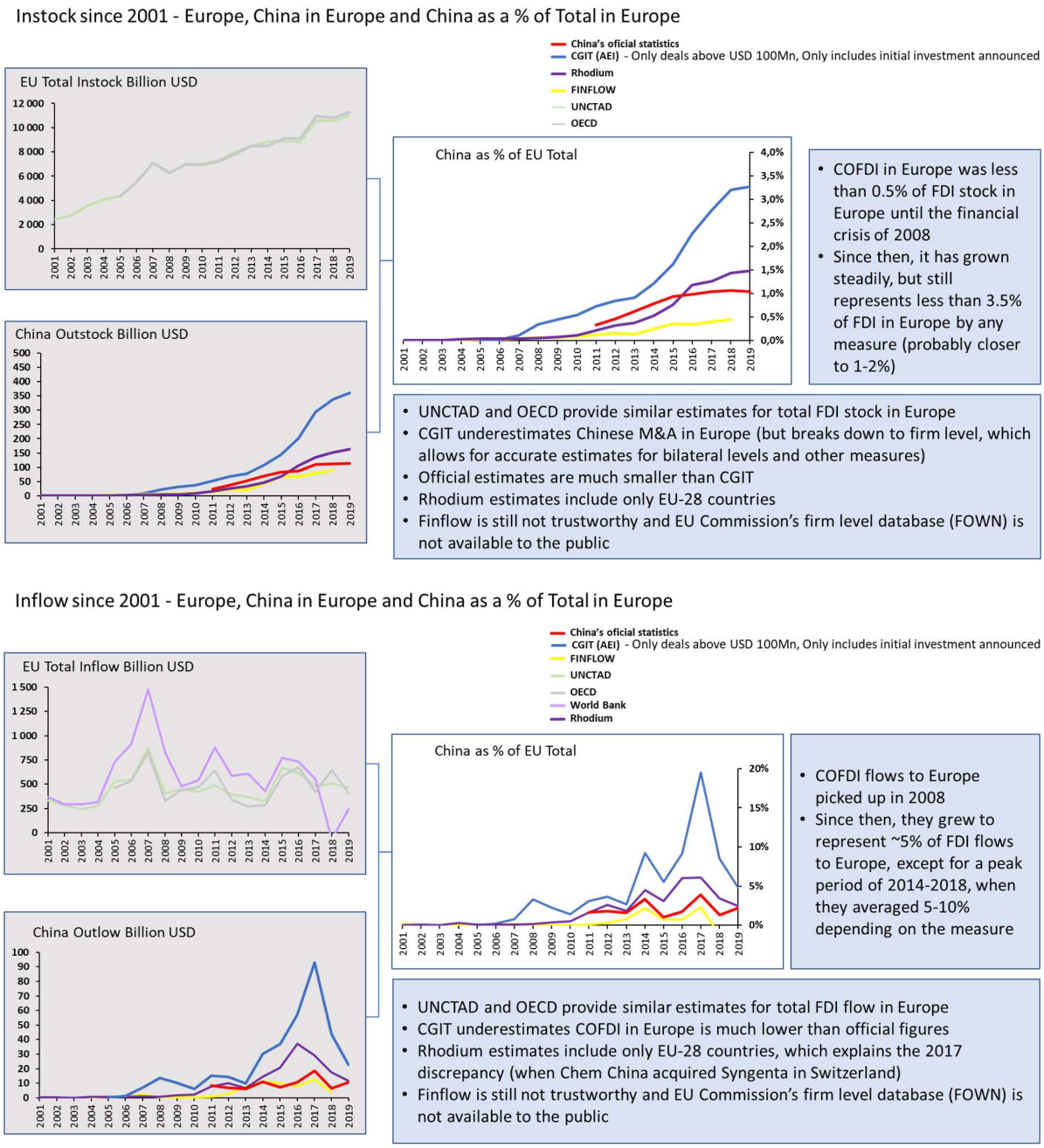


Source: (McKinsey, 2017)

4.c.iii. COFDI quantification in the EU

The volume of COFDI in Europe is displayed in Figure 96 which also presents its weight compared to total stock (and flow) of IFDI in Europe. For stock in Europe, we have UNCTAD, WB and OECD. For COFDI in Europe we have CGIT, Rhodium, MOFCOM, and Finflow. For COFDI as a percentage of IFDI using CGIT and Rhodium we use UNCTAD as denominator.

Figure 96. COFDI stock in Europe since 2001



Source: By the author using CGIT, Rhodium, Finflow, UNCTAD, OECD, WB

CGIT includes Switzerland and some non-EU European countries, whereas Rhodium includes only EU-28 countries. FDI in Europe grew from USD ~2Tri to ~11Tri in 2019. COFDI in Europe was <0.5 percent of the stock until the financial crisis. Since then, it grew fast but is still <3.5 percent of FDI stock in Europe. It represents ~5 percent of FDI flows, except in 2014-18, when it reached 5-10 percent (excluding the Syngenta deal in Switzerland.

Figure 97 shows the geographical evolution of COFDI in 23 European countries.

Figure 97. Evolution of COFDI in each European country

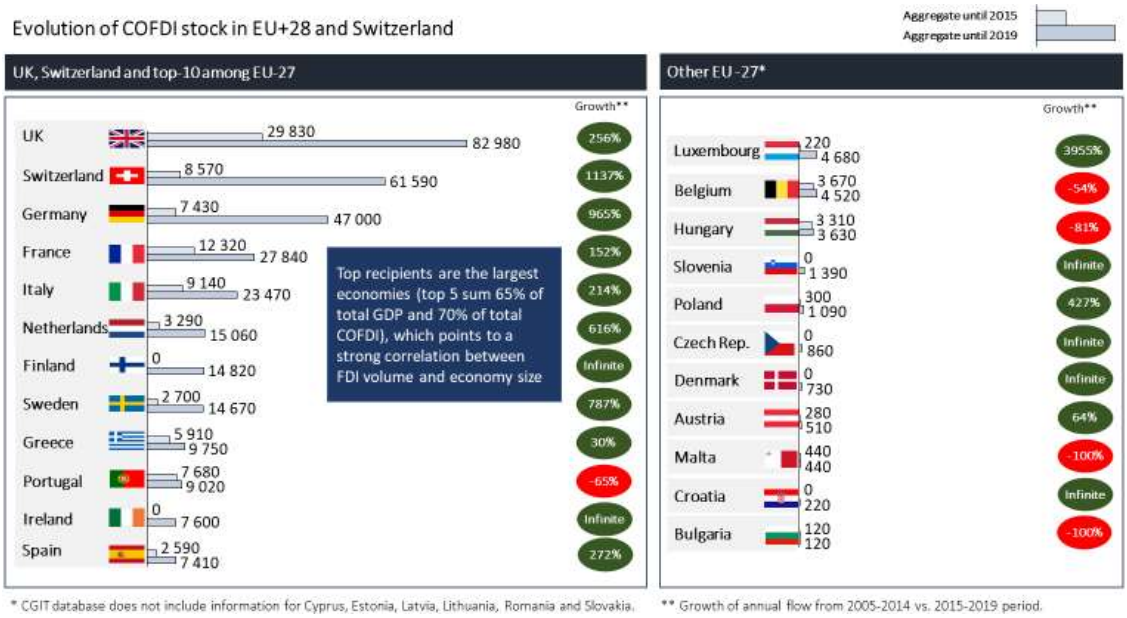
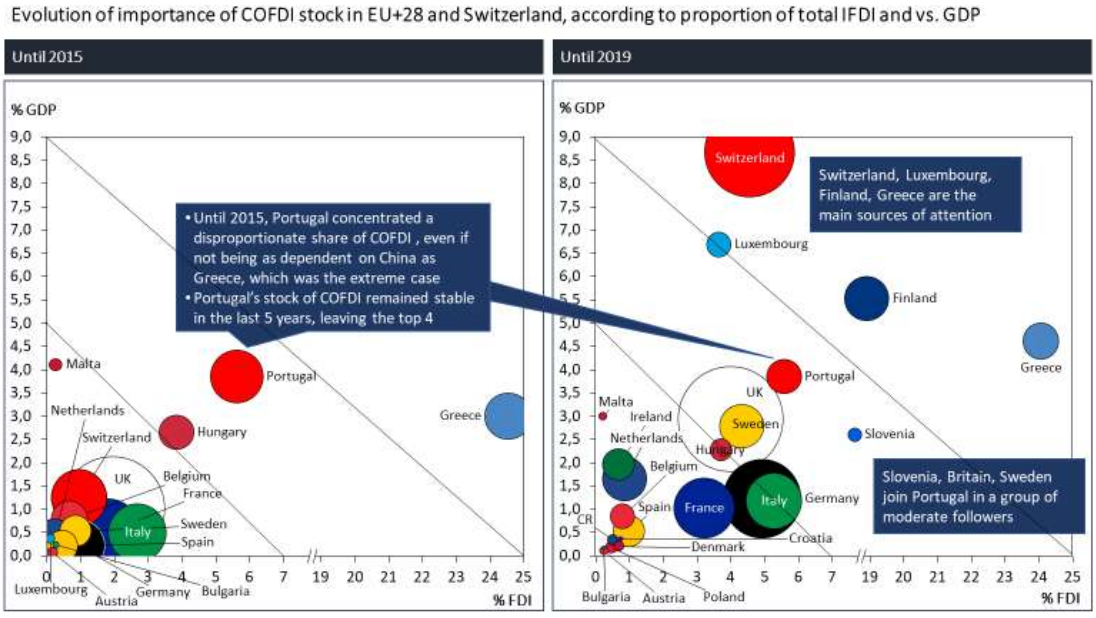


Figure 98. Importance of COFDI in each European country

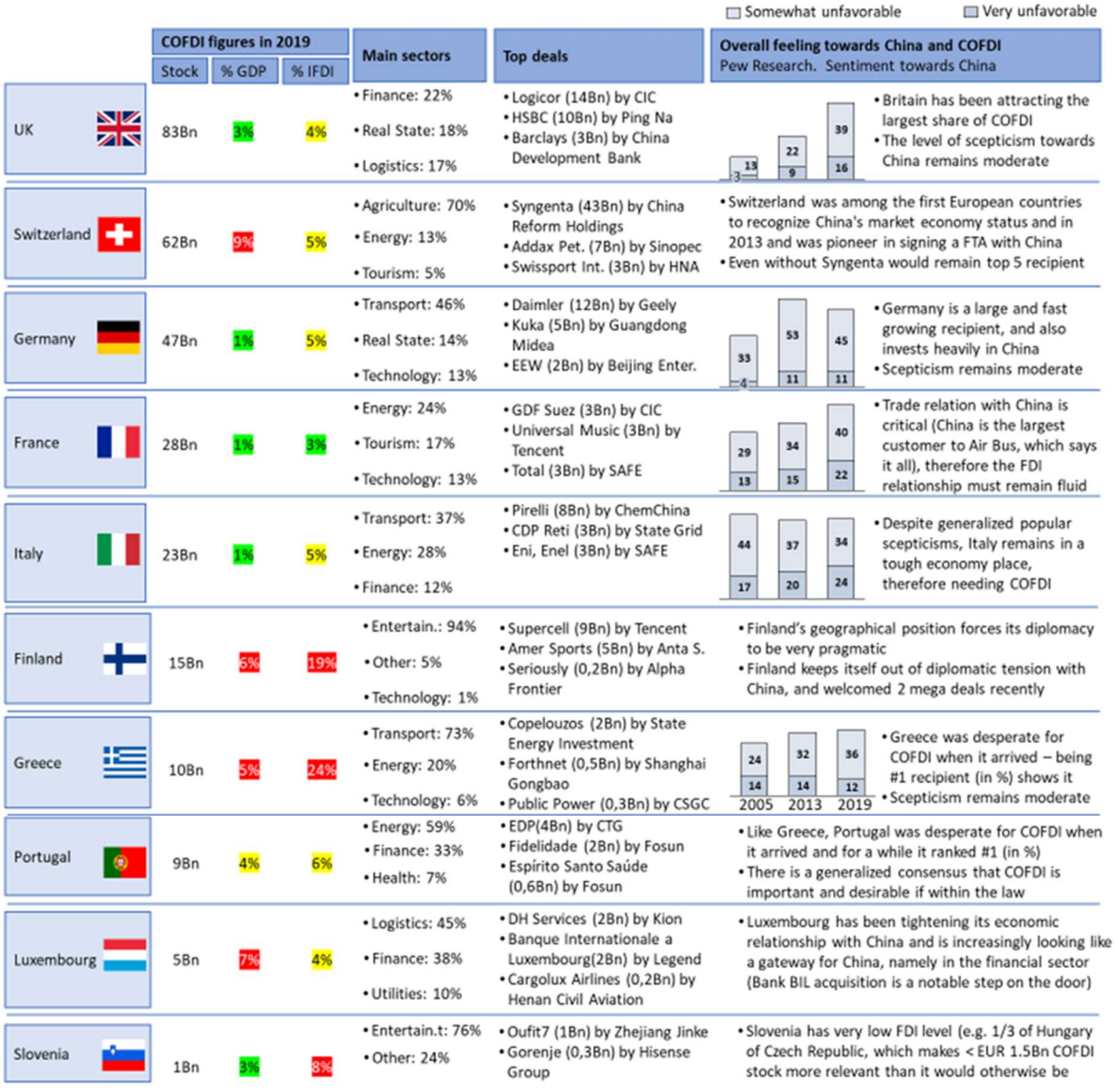


Source: By the author using CGIT database

The UK and Switzerland are by far the largest recipients (attracting EUR ~150 Bn) and are growing fast. Among the EU-27, the largest recipients are the largest economies (Germany, France, and Italy) which concentrate 50 percent of the remaining amount. This implies a strong correlation between nominal GDP and COFDI. Figure 98 analyzes which countries have a disproportionate share of COFDI by comparing COFDI stock in 2015 (and 2019) with total GDP and total IFDI. While Greece, Portugal and Malta were the outliers in 2015, by 2019 the outliers are Greece, Switzerland, Finland, and Luxembourg.

Figure 99 describes the COFDI in the 10 countries where it is most welcomed.

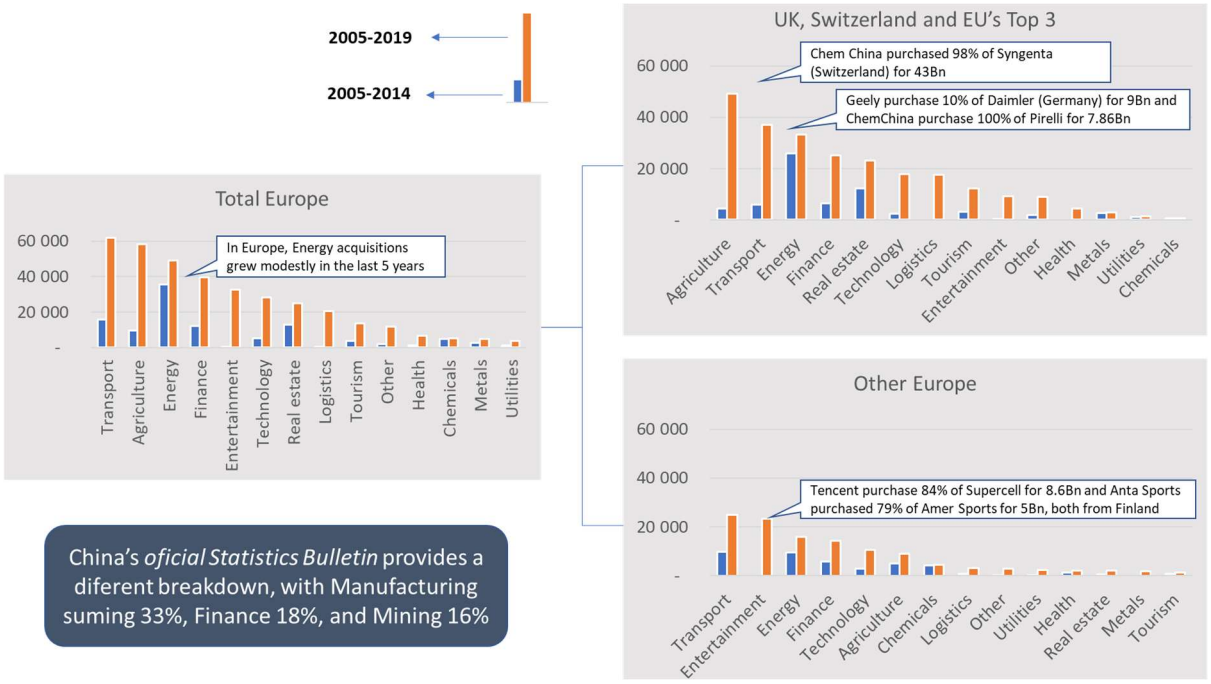
Figure 99. Deep dive into key features of COFDI in top 10 countries



Source: Source: By the author, using CGIT database

Regarding the sectorial breakdown (Figure 100), the top 3 sectors in Europe are also energy, transport, and agriculture (like in the global breakdown) but with a different order – energy, which grew modestly in the last 5 years, ranks third in Europe. The preponderance of transport and agriculture is explained by a few mega transactions, namely Syngenta (USD 43 Bn) in agriculture, and Daimler (USD 9 Bn) and Pirelli (USD 7.9 Bn) in transportation. Finance is another important sector, which ranks fourth, and entertainment ranks fifth, driven by two mega deals that took place in Finland in the last 5 years (Supercell and Amer Sports).

Figure 100. Sectorial decomposition of COFDI in Europe since 2005

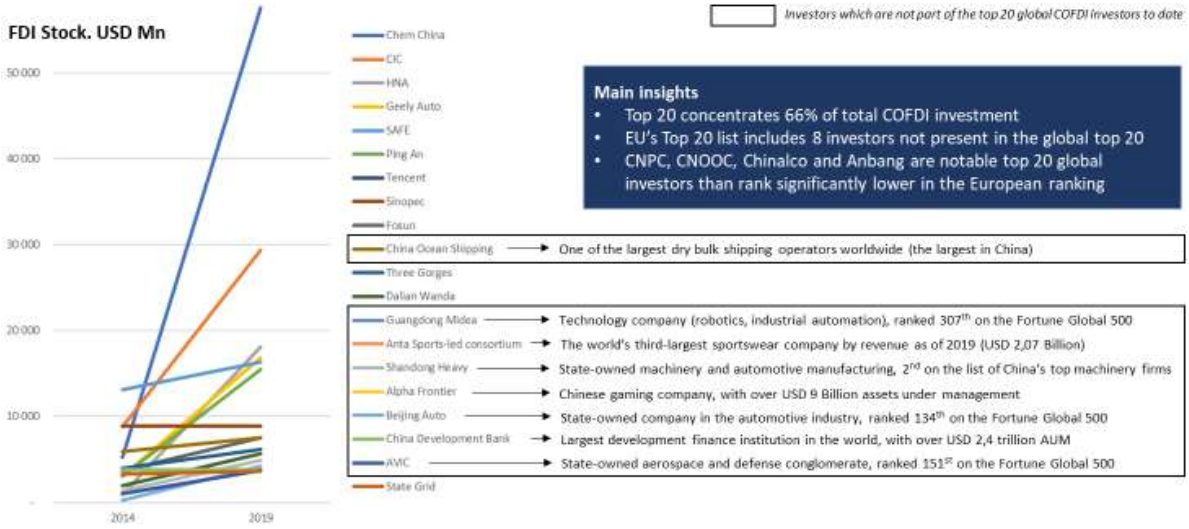


Source: By the author, using CGIT database and (MOFCOM, NBS, & SAFE, 2020)

The average deal size (of those above USD 100Mn) is volatile and averages USD ~900 Mn. According to the CGIT database, the proportion of majority transitions is also volatile, averages 70 percent, and is decreasing since 2016.

The concentration in the top 20 investors (66 percent) is higher in Europe (Figure 101) than globally, and eight investors which were part of the global top 20 are absent in the EU's list.

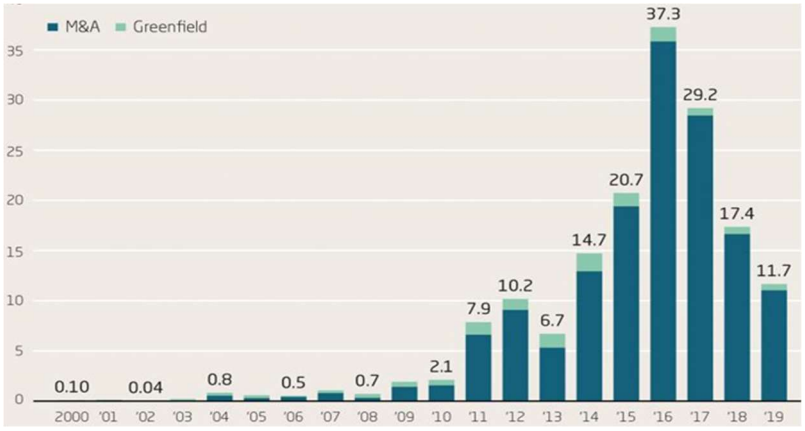
Figure 101. Stock of COFDI of top 20 Chinese Investors in Europe



Source: By the author, using CGIT database and company's websites

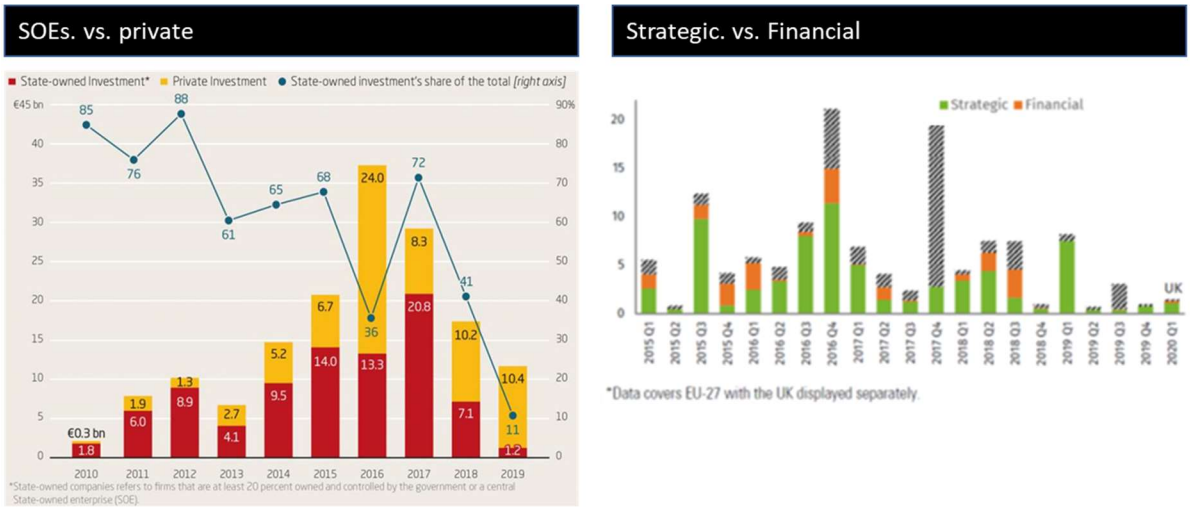
According to Rhodium, COFDI in Europe is very skewed towards M&A (Figure 102).

Figure 102. Greenfield vs. M&A breakdown of COFDI in the EU



Source: (Kratz, Huotari, Hanemann, & Arcesati, 2020)

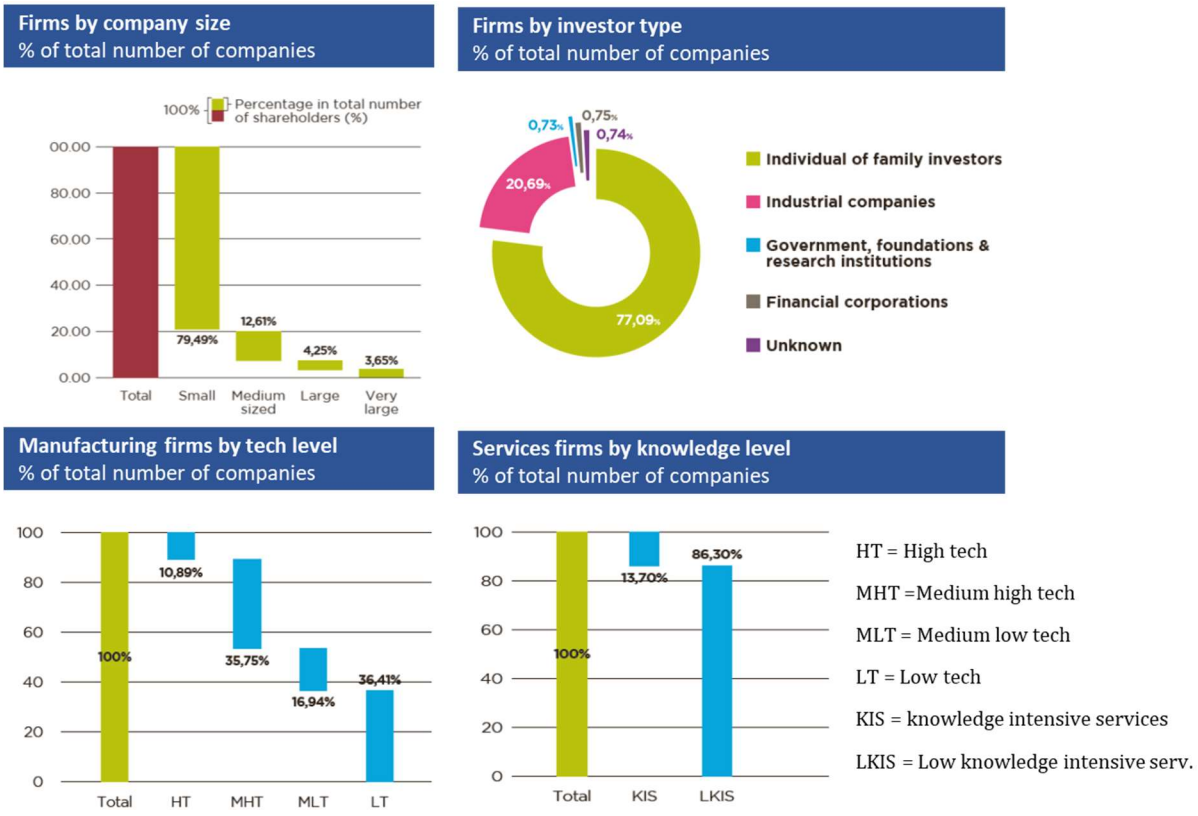
Figure 103. Chinese OFDI in the EU-28 by investor type



Source: (Kratz, Huotari, Hanemann, & Arcesati, 2020)

The same source reveals that the proportion of SOE investment has reduced from 60-90 percent to 11 percent in 2019 (Figure 103). The degree of *privateness* in China is covered later, but China seems to be increasingly privileging private and strategic investors for M&A in Europe. The Antwerp Management School analyzed 10,689 Chinese-owned firms. Figure 104 shows that 80 percent are small and 77 percent are owned by individuals or families. In manufacturing, 11 percent are high tech, and among services firms, 14 percent are knowledge intensive.

Figure 104. Breakdown of 2015's Amadeus Database by firm size and type



Source: (Zhang & Wei, 2015)

Figure 105 shows that only 44 percent of Chinese owned firms are wholly-owned subsidiaries, but the proportion is higher (~63 percent) among SOE or Private conglomerates (not individuals). There is no meaningful difference in the proportion when comparing different levels of technology or knowledge intensity. Average firm size is larger in Northern Europe and in SOEs, and smaller in Eastern Europe and in individuals-owned firms.

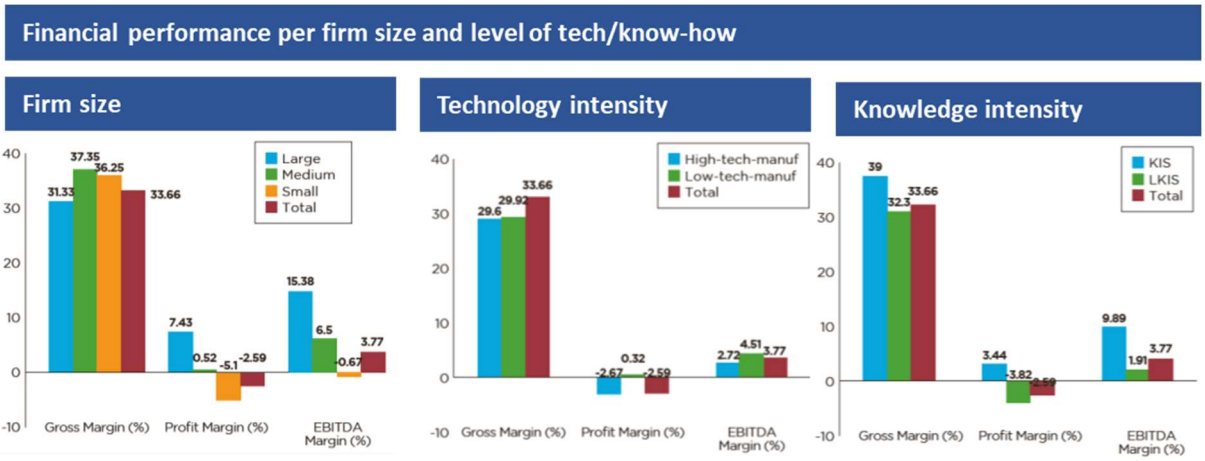
Figure 105. Firms by type, ownership, tech/know-how intensity, sub-region



Source: (Zhang & Wei, 2015)

The financial performance is weak. EBITDA margins are ~4 percent and profit margin is negative 3 percent, although best among large or high-knowledge firms (Figure 106).

Figure. 106 Financial performance of COFDI in Europe (as of 2015)



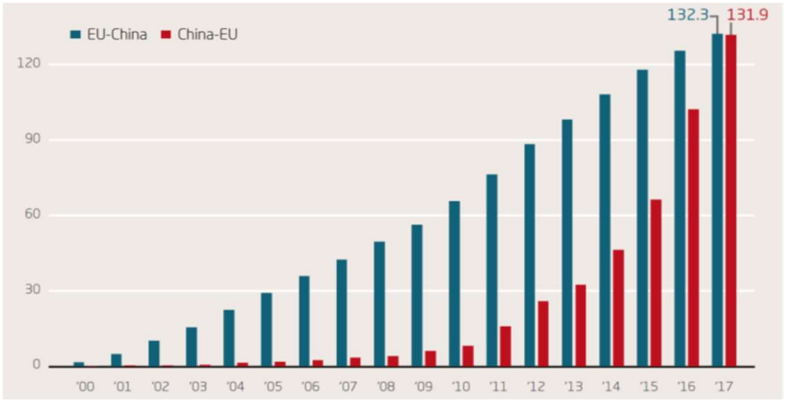
Source: (Zhang & Wei, 2015)

It is hard to find information on the financing of COFDI. The World Resources Institute provided a breakdown of USD 3.3 Tri of financing (outstanding in 2013), showing that 33 percent came from Chinese development banks, 7 percent from Chinese export credit agency, and 18 percent from EIB (Zhou & Leung, 2015).

Comparing COFDI in the EU to EU OFDI we see that China is still a medium-sized FDI partner. The USA and the UK are the main FDI partners. USA accounts for ~25 percent of EU OFDI, followed by the UK with 21 percent and Switzerland with 12 percent (Eurostat, 2020)

As it can be seen in Figure 107, EU OFDI in China used to be higher than COFDI in the EU, but now it is even.

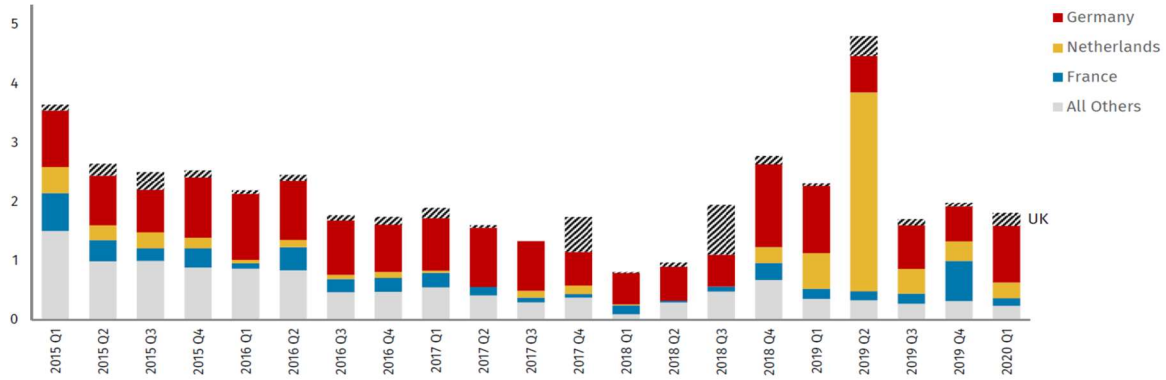
Figure 107. COFDI in the EU vs. EU's FDI in China



Source: (Hanemann & Huotari, 2018)

Germany, France and NL are the largest European investors in China (Figure 108).

Figure 108. Geographical concentration of EU's FDI in China



Source: (Kratz, Huotari, Hanemann, & Arcesati, 2020)

4.c.iv. Determinants and strategies of COFDI

The first book published about COFDI in Europe was *China's Offensive in Europe* (2016), by Le Corre and Sepulchre. It relies too much on media, too little on academic sources, and seems spread too thin. It claims to cover the Portuguese case, but does so in two pages, filled with mistakes (e.g., saying that Fosun acquired 80 percent of Fidelidade for EUR 1 Mn, instead of the actual EUR 1.2 Bn). It argues that COFDI in Europe was intended to divide the US and the EU, starting from weaker countries like Italy, solely backed by the opinion of Alberto Forchielli, an investment professional. COFDI data reveals that China focused on the top 3 European countries, and then Portugal, before turning into Italy in 2013 (USD 4.2 Bn purchase of Eni in 2013 and investments of USD ~13 Bn in 2014-15).

Pop science publications are entertaining but not proper for advancing the scientific debate. The book refers valid reasons why Portugal joined the UK, France and Germany as priority partners for China in Europe: (1) the existence of the CPLP; (2) the historical ties from the Portuguese sovereignty over Macau; and (3) the golden visa policy offering EU citizenship to foreigners investing EUR >500,000. This view neglects the disproportionate role played by Troika's privatization program. It focuses on Chinese *push* motives and ignores Portuguese *pull* dynamics. Understanding COFDI in the EU requires a deeper and more balanced analysis.

As mentioned, the rise of COFDI is explained by economic and political factors from both China and the EU countries, whereas the decline was more politically driven (by both sides). Figure 2 organized the COFDI determinants, splitting them in push vs. pull factors, and economic vs. political. It also presented the reasons for the reduction since 2018.

The hypothetical Chinese appetite for political influence in the EU is covered in Chapter 5 with broader context. The topic is highlighted to single it out as one among several factors. For now, it should be considered as *at least a nice-to-have upside*.

First, the Chinese *push* business motivations. Already in 2005, it was pointed out that "while mainstream theory tends to assume that firms internationalize to exploit competitive advantages, Chinese firms are generally making such investments in order to address competitive disadvantages" (Child & Rodrigues, 2005). Those authors argued that understanding COFDI required "theorizing in four primary areas concerning the latecomer perspective and catch-up strategies, institutional analysis with reference to the role of government, the relations between entrepreneurs and institutions, and the liability of foreignness". In other words, Chinese firms use OFDI to catch up faster, in a context of a blurred frontier between the public and the private and facing the prejudice about China as an origin. In 2005, when COFDI was still associated with resource-seeking, they analyzed market-seeking COFDI and concluded that many seek "technological and brand assets to create a competitive position in international markets" (Child & Rodrigues, 2005).

Chinese MNE internationalized faster, further away and with higher commitment methods (via M&A) compared to MNE from developed countries (Ramamurti & Hillemann, 2017). Therefore, traditional FDI theories failed to explain COFDI.

At the same time, Dunning's four (business) motivations frequently drive COFDI. Some Chinese investors seek natural resources, others seek efficiency, and those struggling with overcapacity seek new markets to avoid downsizing. COFDI investors increasingly seek strategic assets to acquire know-how, technology, and brands for catching up with leading MNE. Therefore, the latecomer theory helps understanding COFDI. Chinese MNE internationalized in a context of globalization and at an earlier stage of maturity, so they can apply leapfrogging strategies and turn their lateness into an advantage.

These are undeniable features of COFDI that also apply to non-Chinese EMNE. What is unique to COFDI is "the competence with which the government used the policy levers at its disposal to improve China's country specific advantages" (Ramamurti & Hillemann, 2017). Some

authors downplay the government-created advantages and worry about the effects of having SOE inside a protectionist bubble, implying that they can only succeed where their Government secures artificial advantages (Clegg & Voss, 2018). The public nature of the Chinese economy is only paralleled by Russia's: "State support for EMNE is widespread in China and Russia but does not significantly influence firms from other emerging nations" (Contractor, 2013).

Theorizing about COFDI requires accounting for the Government's role. The theoretical conceptualization of this, the *institutional theory*, was created by North (1990), and fine-tuned by Deng (2004), who coined the *Government steward logic*. For them emerging markets' governments have more influence over the domestic firms. The influence can be direct or follow unclear links between politics and business. But private decision-making is not independent:

> "That firms in China are state-supported and are guided by state dominated institutions, and that they exhibit conformist and isomorphic behavior, hardly needed empirical verification, but was demonstrated by Cui and Jiang (2012) who tracked the investment behavior of 132 FDI entries made by Chinese firms." (Contractor, 2013).

The question is not if the state influences the private, but instead under which circumstances. The frontier between business factors and political factors is blurred, and it is not possible to understand COFDI without comprehending this blurriness. First, SOE represent a large share of the economy and they are directly controlled by the state. Second, it is not that all business decisions are made in pursuit of the political objectives, but Chinese businesspeople have easier lives when aligned with the CCP's guidelines. Third, the party takes responsibility for advancing economic growth and support loyal firms with unprecedented financial and political resources. Finally, private ownership in China is not absolute. Article 13 of its Constitution defines that "the State may, in the public interest and in accordance with law, expropriate or requisition private property for its use and make compensation for the private property expropriated or requisition" (Constitution, 2020). Article 7 of the National Intelligence Law (2017) furthers the "obligation of Chinese citizens to support national intelligence work"

(Girard, 2019). Article 14 insists that "state intelligence work organs, when legally carrying forth intelligence work, may demand that concerned organs, organizations, or citizens provide needed support, assistance, and cooperation" (Girard, 2019). The state does not actively control all firms but the right to intervene is recognized and feared.

In 2015, a decisive paper (Milhaupt & Zheng, 2015) challenged the relevance of the distinction among ownership types when analyzing COFDI. First, "the Chinese state has less control over SOEs and more control over private firms than its ownership interest in the firms suggests". Despite having control over the appointment of senior executives of SOE, "the State often fails to implement major operational and policy decisions". Moreover, "the State influences SOE behavior principally in its role as a regulator, not as a controlling shareholder". Private firms "bear striking resemblance to SOEs along the dimensions typically thought to distinguish" state ownership. All relevant private firms have "ready access to state power and largesse, proximity to the regulatory process, and little autonomy from discretionary state intervention in business judgement". Former SOE which are privatized never dissolve their links to the political establishment. Moreover, the entrepreneurs of the rising private firms invariably and inevitably seek political protection. This "institutional bridging" is pursued through the affiliation to political organs, even if sometimes "connections to the political establishment may have purposefully been kept informal to avoid suspicion about their private firm's motives". These affiliations are required to signal "allegiance to and influence within the party system". Other blurring mechanisms are Government financing and the extra-legal control of private firms (e.g., through industry associations, audiences with regulators).

Second, SOE and large private firms alike are captured by the state, it just happens that they become captured through different mechanisms. It builds on the work from Hellman, Jones and Kaufmann, namely *Seize the State, Seize the Day: State Capture and Influence in Transition Economies*, focusing on Eastern Europe. Uses the same notion of two types of powerful firms

existing in economies with insecure property rights: the *influential firms* which are "incumbents, typically SOEs, that inherited their privileged position from the previous communist system" and the captor firms "that chose to engage in state capture as a strategy to compete" and purchase advantages directly from the State (Milhaupt & Zheng, 2015). The authors explain that in China the advantages are also *purchased* but the "currency used by captor firms is not bribes, but growth potential". CCP's "overriding primacy placed on sustained economic growth has enabled some private firms to obtain special benefits from the state by demonstrating the potential to deliver that growth". They argue that China materializes Olson's concept of *encompassing coalition*, which is "a group representing a large enough segment of the population that it has incentives to grow the pie. By creating dense networks of managerial elites permeating both policies and business in China, an encompassing coalition has been created with the control over developmental policy" (Milhaupt & Zheng, 2015).

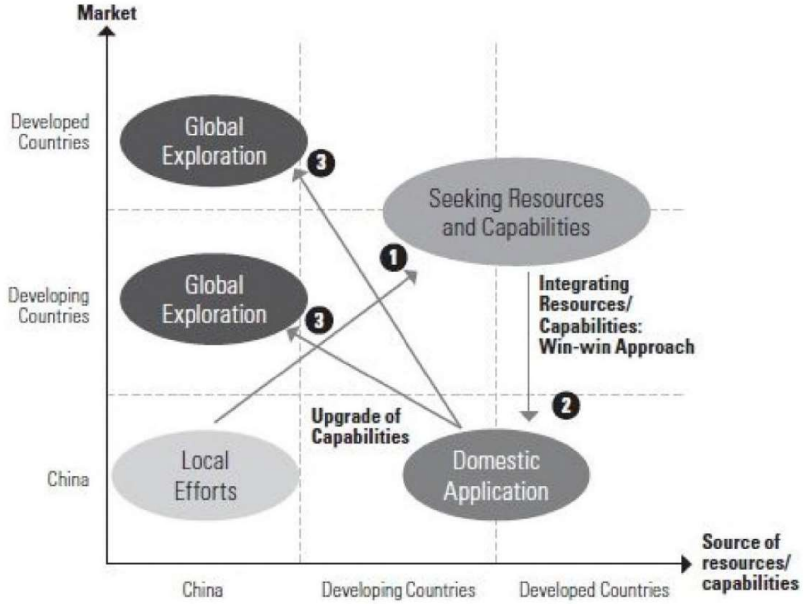
Chinese firms internationalize "to compensate for their shortcomings and to establish their own competitiveness in China and beyond by acquiring resources and capabilities in the overseas market" (Chen, Ding, Meyer, Wang, & Xin, 2018). Another hypothesis being researched is if SOE are suited to address market failures also in host countries: "SOEs may even be credited with generating greater positive spillovers within the host economy if they are fulfilling a perceived investment gap that other foreign investors ignored." (Clegg & Voss, 2018). This could explain the "overpayment in acquisitions coupled with lack of clarity in strategic focus". In his interview, the Secretary General of the China-Portugal Chamber of Commerce argues that the political nature of SOE offers a channel of influence from Portugal to the Chinese leadership which works as a buffer of economic impact. The OLI theory explains this phenomenon differently: Chinese firms, used to riskier markets and weaker institutions, are better equipped to exploit opportunities in high-risk situations.

Chinese SOE and private firms have different expansion patterns. Private firms are attracted

> "by large markets and host-country strategic assets and are averse to economic and political risks when choosing investment locations abroad. Differently, SOEs or controlled enterprises follow the strategic needs of their home country and invest more in natural resource sectors, being largely indifferent to the political and economic conditions in the host countries" (Amighini, Rabellotti, & Sanfilippo, 2013)

In 2018, the China Europe International Business School published a review of Chinese international M&A strategies and synthesized a three-stage framework (Figure 109).

Figure 109. Chinese enterprises' three-stage path to internationalization



Source: (Chen, Ding, Meyer, Wang, & Xin, 2018)

In the initial stage, *local efforts*, "Chinese enterprises tend to accumulate business experience and develop firm specific advantages in China before expanding". The internationalization starts with a period of *seeking resources and capabilities* in both developed and developing countries "mostly via overseas M&A, to compensate for their own competitive weaknesses". Next comes the *domestic application*: "by integrating their newly acquired resources and capabilities with local features, Chinese companies start to catch up with international standards and to develop their own competitive advantages". In their *global exploration*, firms "expand in the global markets by leveraging their own competitive advantages and local benefits".

Beyond business motivations, the OFDI promotion system and the financial diversification goal are also important. China has gradually built its promotion system with ups and downs, and the

CCP is less in control of COFDI than it looks. When the economy opened in 1982 FDI was forbidden. It was sporadically permitted since 1989 to enable exports of selected SOE. The *Going Out* policy was launched in 2001, and FDI picked up in 2004, when the MOFCOM and the State Council issued jointly "the regulation of starting a business approval matters on the mainland enterprises to HK and Macau" (Zhang & Corrie, 2018). In 2006, MOFCOM issued the *Opinions on Encouraging and Supporting the Going Out of the Enterprises*, which was the first regulation focused on private firms. In 2007, it was issued *Several Suggestions on Encouraging, Supporting and Guiding Foreign Investment and Cooperation of Non-Public Enterprises.* Since 2010, MOFCOM publishes the *Guide of Outbound Investment and cooperation by country/region*, ranking the environment faced by COFDI abroad. In the first edition, Portugal ranked 1st (Zhang B. , 2012).

In 2012, it was decided that the financial crisis in the West offered a unique opportunity, and the approval and management procedures were adjusted accordingly (Figure 110). This is very explicit in the 9th point of *2012 Report on the Work of the Government* delivered by the Premier Wen Jiabao in the 5th session of the Eleventh National People's Congress

> "With COFDI in an important stage of accelerated development, we will enhance macro-guidance, increase policy support, streamline approval procedures, and improve services for Chinese investors. We will guide Chinese enterprises under various forms of ownership in making overseas investments, mergers and acquisitions in energy, raw materials, agriculture, manufacturing, service industries, and infrastructure in an orderly manner. We will explore new models for overseas economic and trade cooperation zones, and support companies making overseas investments in coordinating their growth and forming clusters." (Jiabao, 2012).

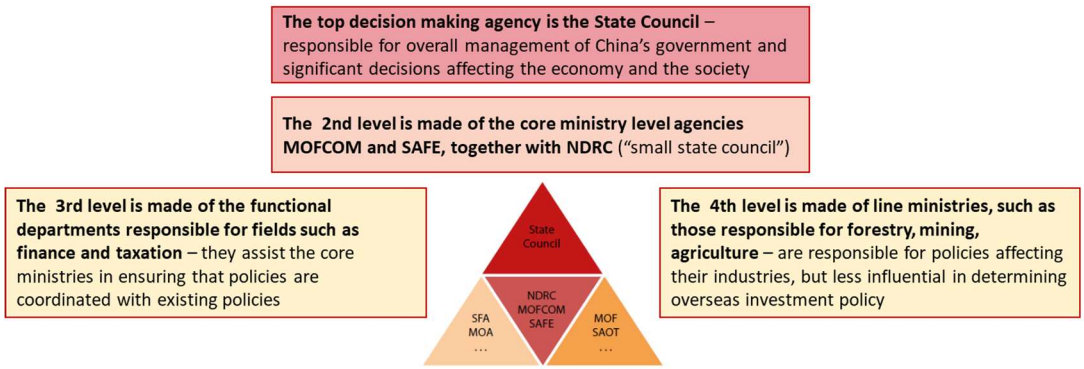
Figure 110. Main policies of Chinese transnational M&A 2012-2015

Time	Department	Case	Effect
2012.2	Ministry of Commerce	Management guide on the overseas Chinese enterprises and personnel safety	Strengthen the protection of personnel safety
2012.6	13 Departments Including the National Development and Reform Commission, Ministry of Foreign Affairs, Ministry of Industry, etc.	Implement opinions on encouraging and guiding the positive overseas investment of private enterprises	Encourage private enterprises to go overseas actively
2012.8	Ministry of Commerce	Management methods for foreign investment approval (draft)	The latest approved method
2013.3	China Securities Regulatory Commission	Regulation about implementing *Measures of Carrying Domestic Securities Investment' Experiment for Foreign Institutional Investors with Qualified RMB*	Put forward the concrete qualification on the registration place, business certification for those applying for qualified investors
2013.11	Exchange Office	Reporting methods about international balance of payments statistics	Simplify management on foreign exchange swap and currency swap's access, increasing principal exchange forms of currency swap business, supporting banks to perfect option pricing and risk management
2013.12	Exchange Office	About adjusting the business management of RMB foreign exchange derivatives	Simplify management on foreign exchange swap and currency swap business access, increasing principal exchange forms of currency swap business, supporting banks to perfect option pricing and risk management
2014.7	National Development and Reform Commission	Management methods on approval and filing of overseas investment projects	Overseas investment projects involving sensitive countries, regions and industries must be approved by the national development and reform commission regardless of quota
2014.11	Ministry of Commerce	Administration measures for overseas investments	The ministry of commerce and the provincial commerce departments manage filing and approval respectively in accordance with the different situations of overseas investment
2014.12	National Development and Reform Commission	Decisions on modifying related terms of *Management* methods about the overseas investment projects' approval and filing and management methods about the foreign investment projects' approval and filling	Paragraph 1 of article 7 is revised as *the Overseas Investment Projects Involving Sensitive Countries, Regions and Industries Must be Approved by the National Development and Reform Commission*
2015.2	State Administration of Foreign Exchange	The notice on further simplifying and improving the administrative policy of direct investment and foreign exchange	Further deepen the reform of the foreign exchange capital's management, promote and facilitate cross-border investment fund's operation, standardize direct investment's management
2015.3	China Insurance Regulatory Commission	The notice of adjusting related policies for overseas investment of insurance funds	Strengthen the regulation on overseas investment of insurance funds, further expand international configuration space of the insurance assets, optimize the configuration structure and guard against the risks of capital operation

Source: (Zhang & Corrie, 2018)

The agencies taking part in COFDI policymaking can be organized along four levels (Figure 111).

Figure 111. China's OFDI management system and main agencies



Top 7 policymaking agencies

- **State council** – highest ranking organ in the central government
- **Ministry of Commerce (MOFCOM) -** supervises OFDI by drafting and implementing policies (including trade and investment agreements) ; Makes final approval of non-financial projects
- **State Administration of Foreign Exchange (SAFE)** – Manages the use and flow of foreign exchange reserves; reports balance of payments
- **National Development and Reform Commission (NDRC)** – main government body that design, regulates and coordinates national economic development and industrial policy; Develops strategies, goals and policies to balance and optimize China's overseas investments
- **Ministry of Finance (MOF)** – drafts and manages laws and regulation regarding accounting and taxation; Prepares annual budget
- **China Securities Regulatory Commission (CSRC)** – is responsible for the overall management of the country's security and futures market, being responsible for Chinese companies' overseas stock issues and debenture activities, stock market listings and related financial activities
- **State Asset Supervision and Administration Commission (SASAC)** – Represents the Chinese government in the largest non-financial SOEs (~120). As an investor, its objective is to ensure the companies remain competitive, increasing their profitability and equity value

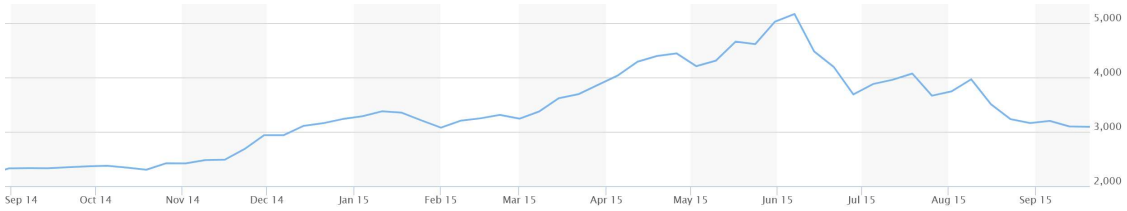
Source: By the author, based on (Wenbin & Wilkes, 2011)

The thresholds of approval responsibility change constantly. In 2004, the first decentralization from the State Council occurred, with MOFCOM getting the ordinary projects (<USD 1 Mn), the State Council responsible for large-scale resource extraction (>USD 200 Mn), and very large FX projects (>USD 50 Mn), and NDRC responsible for those in between. In 2007, central government SOE gained independence on investments of <USD 10Mn and resource-extraction projects of <USD 30Mn. In 2009, MOFCOM focused on projects above >USD 100Mn.

Regardless from the official threshold, there was too much shopping impetus and too few hands to evaluate projects, so the default was to let the capital flow. The banking system could have been a filter but when the request came from an SOE or a well-connected firm it was hard to say no, even if the necessary information was not shared with the bank (Collier, 2018). One of the interviewees attended the 2012 Chinese Investment Agencies gathering and witnessed a crucial announcement: to circumvent the Western skepticism to sell controlling stakes in strategic industries to SOE, China should use "private" acquirers.

By 2015, COFDI rose to unprecedented amounts, but without a market mechanism and a solid administration system it led to "problems such as lack of control, blind development, high risk and widespread losses/corruption keep occurring. Rule of man often causes too tight, or too loose control" (Pei & Zheng, 2015). In parallel, the stock market inflated (grew 150 percent in one year) and then burst in June 2015, wiping off USD 2.5Tri in 22 days (Figure 112).

Figure 112. Shanghai Composite 2015 crash. USD Bn



Source: (Market_Watch, 2020)

The Chinese Government cannot deflect the blame for what happened. It is mostly due to the

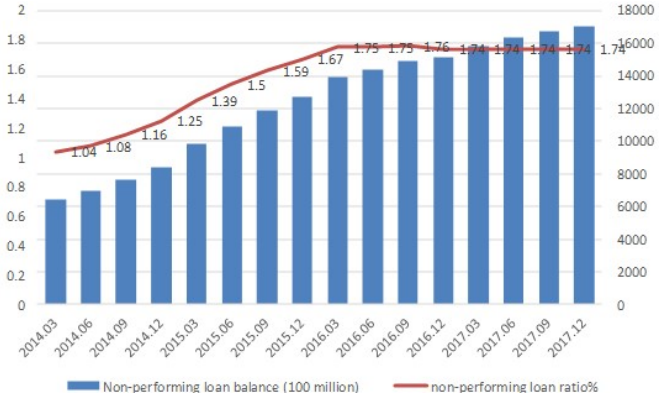
> "government's strategy to solve the debt problem of zombie SOEs and the government's (China Securities Regulatory Commission) facilitation of margin trading by relaxing the previous restrictions. This coincided with the timing when the Chinese property market went down, and people who were putting their money in property began looking elsewhere for better returns. Lots of novice investors got into the stock market because the Communist Party, in word and deed, was pushing them into a debt-fueled binge in the stock market. State media also played a prominent role in drumming up the stock market bubble in the first place. The official Xinhua News Agency published eight articles on the stock market in a space of three days in early September 2014 to solicit investors joining the historic gambling… As the Economist puts it, "The government got all of the corporations in China that were going broke to go public. Then, they got the average Chinese citizen to invest." (Zeng, Huang, & Hueng, 2017).

Inevitably, in 2017, "Beijing suddenly put a halt to the aggressive overseas acquisitions". At first, the State Council tried to avoid panic, intervening under the radar:

> "the banking regulator, the CBRC, quietly (although not so quietly once the work leaked out) ordered banks to deny loans to a small group of companies. Such deals were *not real…they are de facto asset transfers*, one of state-run CCTV researcher noted. 'They were not meant to invest money for profit but to move assets abroad' said Yin Zhongli, who works for the Chinese Academy of Social Sciences" (Collier, 2018).

As shown in figures 116-117, most transactions were value destructive, therefore, after a few years, the financing banks started seeing a wave of non-performing loans (NPL) (Figure 113).

Figure 113. China's NPL balance and ratio 2014-17



Source: (Zhu, 2018)

2017's policy shift introduced the quality screening filter that was missing. Some sectors were endorsed, others prohibited or discouraged (Figure 114), and the grey rhinos were halted "hence the highly visible denial for funding for large Chinese corporates including Dalian Wanda, HNA, and Anbang" (Collier, 2018). The State Council issued the *Guiding Opinions on Further Guiding and Regulating the Direction of Outbound Investments* (draft by the NDRC, MOFCOM, PBOC and the Ministry of Foreign Affairs. The NDRC issued the *Administrative Measures for Outbound Investment determining provisions for outbound investment entities, supervision methods and improving outbound investment supervision systems*.

Figure 114. Investment approval thresholds (as of 2017)

Investment type	Amount invested	If the domestic entity directly invests, or finances or guarantees the transaction	If the domestic entity does it via nan overseas subsidiary
Sensitive project	Any	Verification by NDRC	
Non-sensitive project	Above USD 300Mn	Record filling at NDRC	Situation report for non-sensitive project with large amount at NDRC
	Below USD 300Mn	Record filling at NDRC or its provincial counterpart (NDRC if a centrally owned SOE)	No pre-transaction verification, record-filling or report is needed

Sensitive countries and regions include:
- Any countries or regions with no Chinese diplomatic relations
- War-torn or civil unrest countries or regions
- Countries or regions whose foreign investment is limited by any international treaties or agreements concluded by China

Sensitive industries in NRDC's Catalogue of Sensitive Industries (2017):
- Development and production of weaponry and equipment
- Development and utilization of cross-border water resources
- News media

Sensitive industries listed in Guo Ban Fa (2017) Regulation No. 74:
- Real estate
- Hospitality
- Film and cinema
- Entertainment industry
- Sports and recreation
- Private equity funds or platforms established outside of China for non-concrete business projects

Source: By the author, based on (Council, 2017), (Council, 2017b)

The current process requires approval from the NDRC and the MOFCOM. SOE require SASAC's pre-approval and to conform to the *Measures for the Supervision and Administration*

of Overseas Investments by Central Enterprises (2017). All sensitive investments (SOE or not) require NDRC approval, and non-sensitive deals USD >300 Mn also require NDRC's check.

COFDI was an important source of diversification for China. In 2014, China held USD 4 Tri of US bonds, which posed financial and geopolitical risk. Finding alternative forms of saving was vital. A senior IMF official shared in his interview that "there are several reasons for China to invest abroad. Each company has its story. But, in aggregate, the driver is the need for diversification. China has massive savings, and it is irrational to leave it all in the USA".

Turning to the pull side, the EU was desperate to attract COFDI, which was regarded as an

> "important current and growing future source of capital, employment and economic activity. European businesses engage intensively with Chinese investors – sometimes becoming willing targets for acquisitions by Chinese firms – and EU governments actively promote and compete for Chinese FDI." (Knoerich & Miedtank, 2018).

This applies to the largest economies, which are also the largest EU investors and exporters to China. Many MNE lobby their governments to pressure for openness from the Chinese side, which explains why, at the EU level, reciprocity, which is irrelevant for smaller countries, is emphasized so much. The necessity was higher for the undercapitalized Mediterranean, which were in severe crisis: "this new source of foreign investment has brought economic opportunities, in particular to EU countries that have been suffering from high unemployment and low growth in the wake of the euro crisis" (Meunier, 2018). The crisis increased the number of assets for sale and generated true bargains: "The supply of European assets for sale increased because of the bursting of RE bubbles, industrial and commercial bankruptcies, and the implementation of privatization programs". Some countries had no choice. The bailed-out states

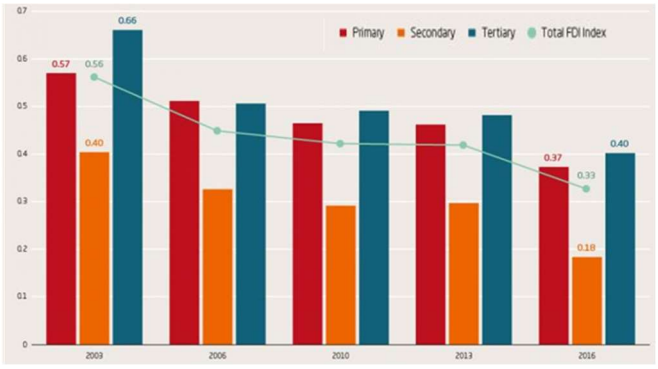
> "were forced by their creditors to sell their public assets as part of privatization programs, notably in Greece, Portugal, and Spain. Assets put up for sale included, in particular, public utilities, tourism facilities, and transportation infrastructure, such as ports and airports. Many of these assets were likely undervalued." (Meunier, 2018).

The problem was worsened by the lack of local investors: “the internal demand for these assets dried up in Europe, where fewer local buyers had become able to invest” (Meunier, 2018).

In 2012, the debate about FDI was much skewed towards liberalization. “Over the past two decades, governments worldwide have continued to liberalize restrictions on international investment with only occasional relapses” (Mistura & Roulet, 2019).

China liberalized slightly (Figure 115) “in the early 2000s but slowed since 2006. That progress virtually stalled until 2013. Since 2014, the pace of reform has picked up again” but remains far from the EU levels (Hanemann & Huotari, 2018).

Figure 115. Evolution of China’s FDI restrictiveness index by sector



Source: (Hanemann & Huotari, 2018)

It is consensual that deregulation increases FDI. OCDE estimates that “reforms liberalizing FDI restrictions by about 10% as measured by the Index could increase bilateral FDI in stocks by 2.1% on average. Effects are greater for FDI in the services sector, but even manufacturing sectors – which are typically open to FDI – are negatively affected by countries’ overall restrictiveness” (Mistura & Roulet, 2019). As such, EU policy makers saw COFDI as beneficial in the short term “because it could save a company from bankruptcy, preserve jobs, and put money in the state’s coffers through privatization programs” and in the long term, because it helps “European companies to penetrate the coveted Chinese market” (Meunier, 2018). They embarked “on active promotional efforts to attract potential Chinese investors. Mayors, local representatives, and heads of state and government have been busy traveling to China and

literally rolling out the red carpet" (Meunier, 2018). Frequently, they sought out COFDI "through the granting of incentives, such as tax breaks and infrastructure" (Meunier, 2018). EU leadership also touted for COFDI. In 2015, China committed to contributing EUR 315 Bn to the *Juncker Plan* and became a member of the European Bank for Reconstruction. In 2017 the European Investment Fund and China's Silk Road Fund decided to start co-investing in Funds investing in small and medium-sized enterprises located in the EU (Meunier, 2018).

As COFDI mounted, the EU decision makers, the media and the public have grown increasingly worried about it. In 2015, the Swedish Defence Research Agency commissioned a report about COFDI and the perceptions about its strategic implications. The study synthesized five concerns: (1) China's ability to wield political influence through a *divide-and-conquer* strategy; (2) Chinese control over some assets with relevance to national security; (3) Chinese corporate governance and business practices threatening employment and environmental standards; (4) lack of investment reciprocity; and (5) lack of transparency and concerns over state interference. The report also noticed that most of the concerns lacked evidence to back them up "propositions that the CCP has embarked on a grand strategy to increase its clout in Europe politically, strategically, and economically are not rare, despite inconclusive evidence that this is the case" (Hellström, 2015). It concluded that "suggestions that the Chinese government is using promises of investment as a political tool, however, have yet to be substantiated". It also revealed that while one of the most important concerns for the largest EU economies is the lack of reciprocity, the truth is that the EU was the largest FDI investor in China, with a total stock equivalent to the COFDI stock in the EU. The report illustrates what was the *median* perception in 2015 – on the one hand there are theoretical challenges which are hard to consubstantiate, on the other hand, several EU economies really needed China's capital and access to China's market. The EU used to be very open to COFDI: there was no EU-wide screening mechanism and few countries discriminated non-EU FDI. This welcoming attitude vanished in the 2020s.

As seen before, the decrease of COFDI since 2017 is not driven by business (de)motivations. In the south, it is correlated with the end of the privatization programs. More broadly, the decline results from increased regulatory selectiveness from both sides. The rationale for caution became clearer and less speculative since then (Figure 116).

Figure 116. Arguments for considering COFDI worse than other FDI

Economic pitfalls	FDI with less spillovers	• One of the main advantages of FDI relates to the **technological and know-how spillovers** into the local economy as workers and R&D move to the host country • In COFDI, **it is China gathering know-how** (which moves in the opposite direction)	• Frequently valid, but was not the driver of the sale (money was)
	Lower labor and environmental standards	• The risk of **"siphoning off",** which consists of gradually reducing local employment • Fears that under Chinese management the companies have **less respect for labor, safety and environmental standards**	• Not frequent
Geoeconomics	Enable China's economic leadership	• ***The Realist argument*** - acquiring strategic assets enables the reduction of the competitiveness gap, which **facilitates China's rise to economic supremacy** • **Unfairly so**, due to state ownership/financing, concertation and lack of reciprocity	• **Critical argument, particularly from US perspective**
Concedes political leverage	Harder promotion of Western Values in China	• **Economic (inter)dependence reduces EU's appetite for holding its ground** in political or geopolitical disputes (e.g., human rights, Taiwan issue) • "Divide and conquer" and "Trojan worse" tactics may bear fruits	• True, but conscious, and politics is about trade-offs
	Easier promotion of Chinese values in the West	• **China owned companies may serve as agents** by spending "small fortunes" in ○ **lobbying** for favorable foreign policy ○ **PR that limits criticism** towards China and defends the "China model"	• True, and must be dealt with by local rule of law
Defence and security threats	Allows access to tech with security applicability	• China is not an Ally and there is an Arms Embargo against China in the EU • Nevertheless, **the acquisition of dual usage technology** (civil technology which can be converted for military purposes) **by China is a very sensitive matter**	• True, and needs to be regulated. Red lines are to be respected
	Opens the flank to boycott and sabotage	• China ownership, and particularly **Chinese operational control over sensitive infrastructure** (e.g., energy production and distribution, other utilities) or other critical economic inputs could be **used for boycott or sabotage** in case of conflict	• Speculative, but needs to be regulated and scrutinized

Source: By the author

From the economic side, "some fear that the net positive economic impact may not happen because the technological and know-how flows do not appear to be going in the *traditional* direction, from the home to the host country" (Meunier, 2018). This effect was ignored at the time of the sales. At least in Portugal, the criteria for winning privatizations were essentially price. Notably, this is a counter-argument for the first concern, because if spillovers were not the criteria, then it is not fair to complain about their inexistence.

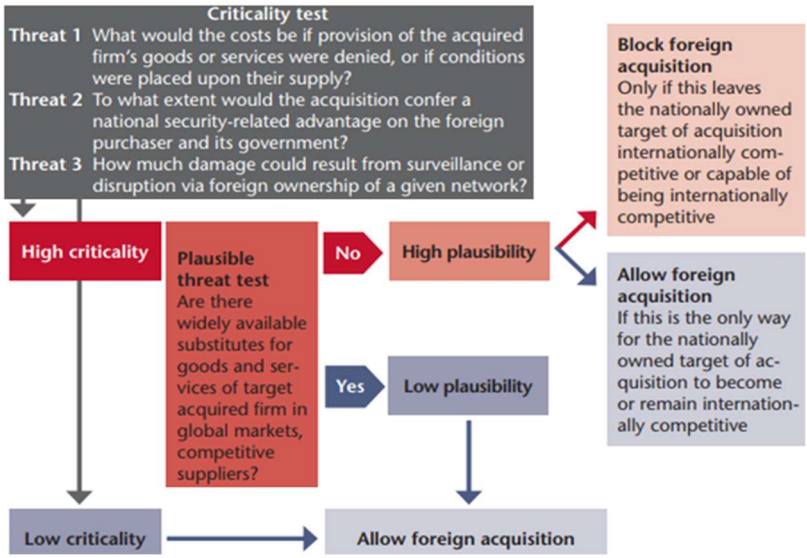
The second economic concern, although hardly ever seen, is about the possibility for the investor to "repatriate to China the assets of the company it took over and virtually close-up shop in the host country" (Meunier, 2018). The third argument is harder to dispute. We saw that realism focuses on the competition among superpowers and relative strength, and Kennedy's argument is that economic strength is the decisive factor in the relative power balance because the military preponderance is sustained by it. Therefore, it is natural that the hegemon (USA)

worries about the growing economic clout of its main contender. By acquiring strategic assets in Europe, China advances economically. The disadvantages are less clear to the EU, because economic engagement with China is economically good for both China and Europe (but not for the USA). As President Marcelo shares in his interview: "I perfectly understand, and I empathize with the American position. If I were in their shoes, I would probably feel the same way". But Europe is not in the America's shoes, so "our allies put us in a difficult position because they ask us to behave in ways which are not necessarily in our economic interests". There is a fairness angle to this argument if China is acquiring assets under privileged conditions including state-ownership, opaque financing, market concertation, and non-reciprocity; 75% COFDI above USD 1 Bn could not happen the other way around (Hanemann & Huotari, 2018). There are arguments related to the promotion of fundamental values. As mentioned, constructivism believes that through interaction, identities are co-constructed. The liberal view expected that through economic engagement, the *superior* Western values would be gradually adopted by China, which would ultimately adopt a liberal democracy. The last decades have witnessed the economic opening without the political opening, which raised two main concerns. First, more engagement with China reduces the West's ability to coerce China into changing its political system or its conceptions over HR. This also reduces EU's appetite for aggressive opposition to Chinese territorial advancements and other geopolitical disputes (e.g., in Taiwan). Second, China may use COFDI in the EU as *agents* who are better positioned to *invest* in PR to promote its policy interests or silence its critics. Both concerns are legitimate: this thesis has found evidence consubstantiating this argument in Portugal (although it is very hard convincing people to share it *on the record)*. Regarding the first, President Marcelo considers futile to hope for Western influence over China's political system. For him, China will change its political regime only if that serves its purposes. Regarding the second, China does not even allow its firms to invest in foreign media (since 2017), but Section 2 discussed how this phenomenon

happens. The Western media is a plural space, where its scrutinizing role is achieved through competing views and not by guaranteeing the independence of every journalist. In fact, most have very clear agendas, few are almost independent, and none is completely independent.

The two main security arguments against COFDI are (1) that selling dual usage technology to China increases its military potential, which is not acceptable for the EU because China is not an ally, and (2) that if China owns a sensitive asset, it may have easier operational access or decision making which can be used against the host country through boycott and sabotage. These two arguments resemble Moran's *three-threat assessment* (Figure 117).

Figure 117. Moran's Three Threat Assessment framework



Source: (Moran T. , 2012)

It is based on three plausible national security logics to block foreign acquisitions. Because "in 2010-11, Canada, Australia and the USA have had complicated reactions" to proposed COFDI, he worried that "national attempts to block foreign corporate acquisitions become a new *protectionist drift* that interferes with the free flow of capital and technology across borders". He laid out a framework to identify the foreign acquisitions posing national security threats. The first threat is if the acquisition makes the host country dependent on a foreign controlled supplier of critical goods or services "who might delay, deny, or place conditions upon provision of those goods or services". The second is if the transaction would "allow transfer of

technology or other expertise to a foreign controlled entity that might be deployed by the entity or its government in a manner harmful to that country's national interests". The third is if the acquisitions "allow insertion of some potential capability for infiltration, surveillance, or sabotage – via a human agent, or non-human agent – into the provision of goods or services crucial to the functioning of that economy" (Moran, 2013). Moran's first and the third questions fit into our second security argument, whereas Moran's second question fits our first security argument.

Both arguments are undisputable and need to be regulated with the utmost responsibility. The second argument is a bit more speculative. There is a general perception in Portugal that, to date, it is unlikely that COFDI was driven by such purposes – a counter argument is that boycott is better operationalized via cyber interference, and it is irrational to spend the money acquiring the asset to sabotage it. Nevertheless, because the possibility exists and it is a serious security matter, it is also consensual that critical infrastructure cannot be controlled by non-allies.

All these arguments contributed to a growing opposition to COFDI in Europe. This pressure comes from the media, from the US administration and from internal nationalistic and protectionist voices (Meunier, 2018). The decision makers became more convinced of the idiosyncrasies of COFDI and treat it as a singular phenomenon. As a result, the EU and several member states have re-regulated FDI to increase their bandwidth for scrutinizing it.

4.d. Evolution of the FDI policies and regulation

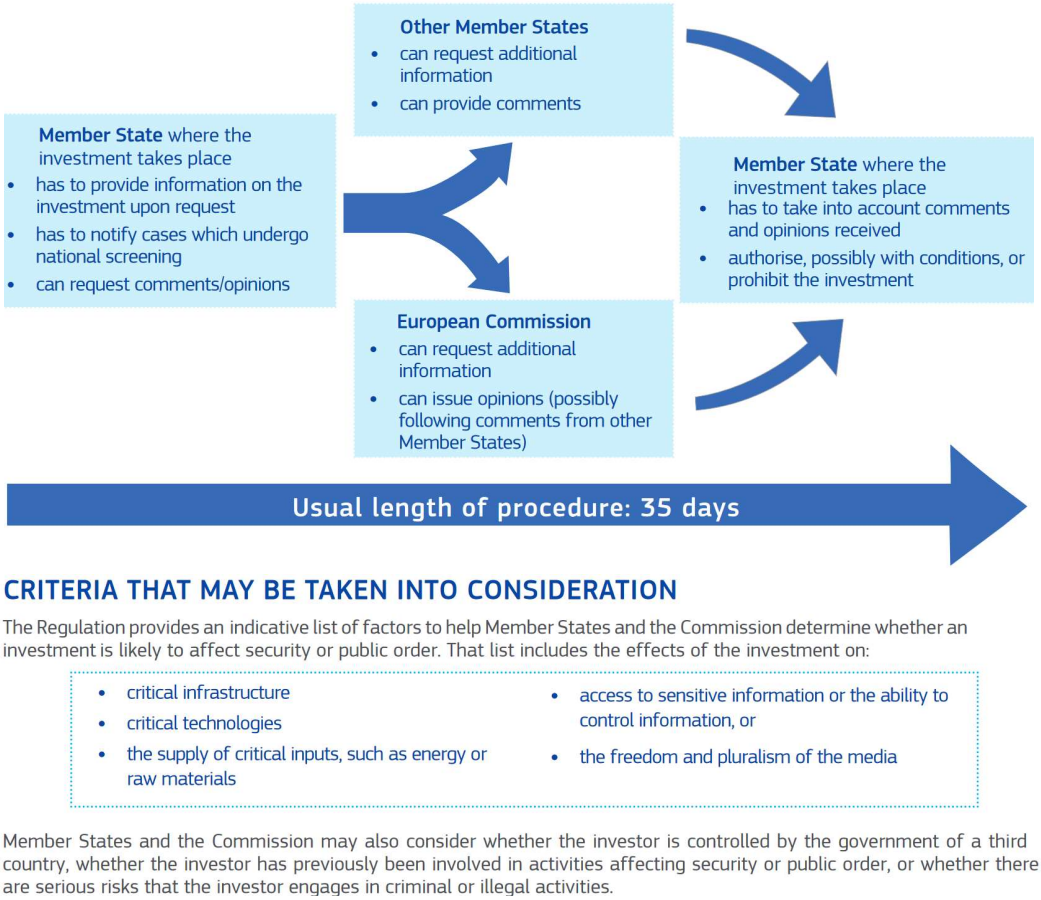
FDI is regulated at three levels: multilateral, bilateral and unilateral. The multilateral efforts to liberalize investment happen essentially at the WTO, but "the discussion for a genuine multilateral agreement started and stopped in the first few years of the WTO" (Drabek & Mavroidis, 2013). Currently, the WTO disciplines induce FDI but do not regulate it. The General Agreement on Trade in Services is "the only multilateral agreement that contains legally binding and enforceable rules with regard to measures affecting foreign investments" and it connects to the international law via WTO's mode 3 of supplying services through commercial presence in the territory of another member (Drabek & Mavroidis, 2013). This is useful in the Doha negotiations for securing common ground, but it is irrelevant in the EU, so we must focus on the bilateral and unilateral mechanisms. Before the Lisbon Treaty, bilateral investment agreements were a prerogative of the states. With it, the EU acquired competence regarding FDI. In 2020, the EU concluded two decisive steps regarding FDI regulation and management: the implementation of an EU-wide FDI screening mechanism and the agreement in principle for the EU-China CAI.

The EU-wide FDI screening mechanism

The EC proposed a screening mechanism (2017) which maintains the state's sovereignty but incorporates EU feedback. It includes 5+3 criteria (Figure 118). Regulation 2019/452 was approved by the Parliament in February 2019 and the framework became operational in October 2020. The objective is to preserve EU's strategic interests while keeping openness to FDI.

> *"*The EU is and will remain open to foreign investment. But this openness is not unconditional. To respond to today's economic challenges, safeguard key European assets and protect collective security, EU Member States and the Commission need to be working closely together. If we want to achieve an open strategic autonomy, having an efficient EU-wide investment screening cooperation is essential. We are now well equipped for that*."* (Dombrovskis, 2020)**.**

Figure 118. EU framework for FDI screening



Source: (EC, 2020)

The host state must provide information about potential FDI transactions, namely identity of the investor, sectors and geographies of operation, amount invested and sources of funding, and timing of the transaction. Then, the EC and other states can request further information and comment on a clear format and time frame. The host needs to consider the comments received. The 5+3 criteria include: critical infrastructure, critical technologies, supply of critical inputs, access to sensitive information, freedom and pluralism of the media, control by the Government of a third country, previous involvement with activities affecting security and serious risks of engagement with criminal or illegal activities. It is too early to understand what will happen in the face of disagreements. At least in the beginning, this instrument will be more effective in helping the host legitimating the blocking of an FDI than in forcing a country to reject a desired investment. This mechanism can be triggered by other member states if the investment poses a

security threat to them. The EU acknowledges that the creation of this mechanism relates to the growth of COFDI until 2017, but it applies to all non-EU origins.

The EU-China Comprehensive Agreement on Investment

After 7 years and 35 rounds of negotiation, the EU and China announced (December 2020) the agreement in principle for the CAI. According to the President of the EC it is a

> *"*landmark in our relationship with China and for our values-based trade agenda. It will provide unprecedented access to the Chinese market for European investors, enabling our businesses to grow and create jobs. It will also commit China to ambitious principles on sustainability, transparency and non-discrimination*"* (Leyen, 2020).

The details of the CAI are not fully finalized but the EU published the Chinese commitments regarding two key topics: EU access to the Chinese market, and fair competition (Figure 119).

Figure 119. Concessions obtained from China in CAI



Source: (EC, 2020)

The EU seems to have achieved significant concessions. First, permission for EU OFDI in more sectors. This is important for the largest EU firms. Second, it secures a level playing field avoiding privileges to SOE and state-backed enterprises (which is hard to enforce in practice). Third, China committed to several international standards about environment, labor and others. Finally, it defines typical technical requirements related to arbitrage and settlement of disputes. For China, the objectives were less about increasing market access, even if it secured some opening in manufacturing and energy (including renewables). Simultaneously, some EU sensitive areas were clearly excluded, including some nuclear energy, agriculture, fisheries,

audio-visual, and public services. The 5G remains open, but it seems probable that it will respect a quota, like the 5 percent share applicable to renewables. China's objective was more diplomatic. The CAI maintains the existing openness to CODFI and is a political statement to Washington:

> *"*First, the deal will preserve and encourage EU investment in China, to fuel China's economy and technological development. Second, it will legitimize the regime in the eyes of domestic and international public opinion... Finally, and perhaps most important of all, the CAI could pre-empt policy coordination on China between the EU and the USA under the new Biden administration*."* (Fallon, 2021).

Before evaluating the screening mechanisms of individual states it is important to understand that "the legal basis for such mechanisms is the Treaty on the Functioning of the European Union (TFEU), which allows Member States to *take such measures as [they] considered necessary for protection of the essential interests of [their] security"*. Article 65 explains that these can be justified on the grounds of public policy or security but cannot constitute *a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 65* (Catrain & Theodoropoulou, 2020). In 2020, 14 states already had such mechanisms, and "by mid-2021 most of not all member states will have a screening mechanism in place" (Catrain & Theodoropoulou, 2020). The Council's Merger Regulation (139/2004) aims to validate that M&A does not pose impediments to effective competition and gives exclusive competence to the EC in very large transactions.

Reviewing the highlights of the individual FDI mechanisms in some countries reveals similarities. What is always at play is the trade-off between protectionism and protecting national security, but there is no universally agreed upon definition of what is to be protected:

> "When the host state addresses the security related concerns by means of a national security review regime of foreign investment, the host state itself becomes the sole judge in determining in what manner and to what extent its national security is to be protected." (Bian, 2020).

The domestic laws identify (differently in each case) the conditions for initiating a review: often by identifying the activity sectors, sometimes determining a threshold of the percentage of ownership/voting rights which constitute *control*, and seldomly the target's size. In the USA all sectors are included, in China 33 sectors are included, and in Germany national defence, governmental IT security and six civil-sensitive sectors are subject to ex-ante review, while others can be subject to ex-post review. Some domestic laws define the factors to be considered in the analysis and all offer timelines. All countries keep discretionary power and are vague about how it works (Germany is the clearest, China and USA are vaguer).

FDI screening in the UK

In the UK, FDI controls are minimal, and the requirements are found in Part 3 of the Enterprise Act 2002. "The UK government, through the secretary of state, may intervene in a transaction on the public interest grounds […] if the transaction is a *special merger situation*, it can be reviewed if it could give rise to concerns regarding media plurality, financial stability, or national security (the defence sector)" (Fraedrich, Kaniecki, & Rafferty, 2018). Special merger situations include companies with sales GBP >70 Mn, or situations in which the investor and the target concentrate >25 percent of the acquisition or provision of a single input in the market. Outside these requirements, it is also possible to investigate significant broadcasters or suppliers of news and relevant government contractors (Fraedrich, Kaniecki, & Rafferty, 2018).

FDI screening in Germany

The regulation of non-EU/EFTA FDI has been subject to intense debate and adaptation. The governing laws are the Foreign Trade and Payments Act (known as *AWG*) and the Foreign Trade and Payments Ordinance (known as *AWV*). Two COFDI cases were emblematic because in both Midea's control acquisition of Kuka and CSGC's 20 percent minority acquisition attempt of 50Hertz the Government wanted to apply screening procedures, but the transaction characteristics did not allow it. As a result, the 9th and the 12th Amendments of the AWV

"substantially widened the scope of government purview and subjected foreign investors to a tougher review procedure" (Bian, 2020). They introduced an ex-ante review procedure to non-EU/EFTA investors acquiring 25 percent of critical infrastructure of four sensitive sectors and lowered the voting rights threshold. The procedure takes place above 25 percent, except for companies in sensitive industries and infrastructures (Figure 120), which have a 10 percent threshold.

Figure 120. Critical Infrastructures in Germany according to AWV

German companies that:

1.operate critical infrastructures within the meaning of the Act on the Federal Office for Information Security (e.g., facilities that (1) belong to the energy, information technology and telecommunications, transport, healthcare, water, food, finance or insurance sector, and (2) are vital to the functioning of the community);

2.develop or modify certain sector-specific software for the operation of critical infrastructures within the meaning of the Act on the Federal Office for Information Security (e.g., software for (1) power plant or network control technology in the energy sector, (2) control and automation technology in the water sector, (3) cash supply, card-based payments or security transactions, (4) hospital information systems or the marketing of prescription drugs, (5) air, rail or road transport of passengers and goods, and (6) food supply);

3.are entrusted with the operation of telecommunications surveillance measures according to the Telecommunications Act or manufacture technical equipment for such measures;

4.provide certain cloud computing services;

5.have an authorisation for components or services related to the telematics infrastructure according to Volume V of the Social Insurance Code;

6.are active in the media sector and, with particular topicality and broad impact, contribute to forming public opinion via broadcasting, 'telemedia' or print media;

7.provide services needed to ensure the trouble-free operation and functioning of state communication infrastructures within the meaning of Section 2 Subsection 1 Sentences 1 and 2 of the Act establishing the Federal Institute for Digital Radio of Authorities and Organisations with Security Responsibilities;

8.develop or manufacture personal protective equipment within the meaning of Article 3(1) of Regulation (EU) 2016/425 of the European Parliament and of the Council of 9 March 2016 on personal protective equipment;

9.develop, manufacture or market essential medicines, including their precursors and active ingredients, within the meaning of Section 2 Subsection 1 of the Medicinal Products Act to ensure the provision of healthcare to the population, or possess a corresponding licence under pharmaceuticals law;

10.develop or manufacture medicinal products within the meaning of medicinal product law intended for diagnosis, prevention, monitoring, predicting, forecasting, treating or alleviating life-threatening and highly infectious diseases; or

11.develop or manufacture in vitro diagnostics within the meaning of medicinal product law that serve to supply information about physiological or pathological processes or conditions or to stipulate or monitor therapeutic measures relating to life-threatening and highly infectious diseases

Source: (Schröder & Birmanns, 2020)

FDI screening in France

FDI is regulated by the *Monetary and Financial Code*. Decree 2005-1739 was modified in 2012, 2014 and 2018, and the modifications are codified in the *Regulatory Part of the Monetary and Financial Code*. Controls "are on the whole fairly lenient, as financial relations between

France and other countries are unrestricted, in principle" (Théophile, Chriqui-Guiot, & Griffart, 2020). In some cases, control stakes require notification and public authorization (Figure 121).

Figure 121. FDI control requirements in France



Source: (Théophile, Chriqui-Guiot, & Griffart, 2020)

FDI screening in Portugal

The *Strategic Assets Special Framework* (Decree-Law 138/2014) was published during the privatization program setting minimal restrictions (Figure 122) applicable to any non-EU control-seeking investment in national strategic assets. Such assets were defined as "those in connection with main infrastructures and assets related to defence and national security, or to the basic energy, transportation and communication services". The Council of Ministers,

following a proposal by the Minister responsible for the sector in question, may oppose a transaction which results in the control of a strategic asset, by a foreign investor, if it poses "a real and severe threat to national security or the provision of basic services considered fundamental to the country" (Faria, Stokes, Martins, & Drago, 2020).

There are also six sectors where regulators scrutinize investors (of all origins): Financial services, Insurance, Energy, Telecommunications, TV Broadcasting and Air Transport.

Figure 122. Portuguese requirements for FDI prohibition

The real and severe threat to national security or the provision of basic services considered fundamental to the country is asserted exclusively by the following criteria:

a the physical security and the integrity of the relevant Strategic Asset;

b the permanent availability and operability of the relevant Strategic Asset, as well as its ability to fully comply with its obligations, in particular the functions of public service that are the responsibility of the entities that control them, in the terms prescribed by law;

c the continuity, regularity and quality of the services of public interest to be provided by the person or company who controls the relevant Strategic Asset; and

d conservation of the confidentiality, imposed by law or public contract, of the data obtained during the course of activity by those who control the relevant Strategic Asset and of the technological resources required for management of the relevant Strategic Asset.

Moreover, the acquisition by a Foreign Investor of Control of a Strategic Asset is considered to be potentially capable of representing a threat to national and homeland security or to the provision of basic services considered to be fundamental for the country, whenever:

a there is serious evidence, based on objective factors, of the existence of a connection between the purchaser and third countries that:

- does not observe the principles of the rule of law;
- represents a risk to the international community as a result of the nature of its alliances;
- maintains relations with criminal or terrorist organisations or with persons associated with such organisations, taking into account the official positions of the European Union in these matters, if any;
- where the purchaser has used, in the past, a controlling shareholding held over other assets with the purpose of creating serious difficulties in the regular provision of essential public services in the country where it was located or in neighbouring countries; or
- does not ensure that neither the allocation of the assets to its main function, nor their reversion at termination of the corresponding concession agreements, if applicable, in particular considering the absence of appropriate contractual provisions for said purpose; or

b the relevant transaction alters the function of the relevant Strategic Asset, threatening the permanent availability and operability of the Strategic Asset to comply with its applicable obligations, in particular the functions of public service, in the terms prescribed by law.

Source: (Faria, Stokes, Martins, & Drago, 2020)

FDI screening in the USA

The body that administers the national security review process is the (interagency) Committee on Foreign Investment in the USA (CFIUS), authorized by Section 721 of the Defense Production Act. The CFIUS (1975) only gained relevance with the appreciation of the Yen vs. the USD, which allowed Japanese investors to find true bargains in the American stock exchange since the 1980s. It was the opposition to Fujitsu's acquisition of Fairchild Semiconductor Corp that ignited the Exon-Florin amendment in 1988. After 4 years of limited track record, there was pressure to upgrade the executive's power against foreign SOE:

> "The fact that the CFIUS only recommended one rejection to the President out of more than 500 fillings under the Exon-Florio from its enactment till 1992 had spurred growing concerns that the President had not sufficiently exerted his presidential power… It was when the French-owned Thomson-CSF proposed to acquire the US-based LTV Corporation's missile division that the Congress manifested its dissatisfaction with the CFIUS review process, which eventually led to the passage of the Byrd Amendment." (Bian, 2020).

And yet, CFIUS remained very passive until recently. There were more transactions prohibited in the last 5 years than in the prior decades (Figure 123).

Figure 123. Presidential prohibitions of transactions in the USA 1988-2018

Acquirer	*Target*	*Sector*	*Alleged threat to US national security*	*Time of Presidential prohibition*	*President responsible for prohibition*
China National Aero-Technology Import and Export Corporation (CATIC)[125]	Mamco Manufacturing Inc.	Airplane component manufacture	The acquirer is likely to gain aircraft engine technology for military application	1990	George Bush
Ralls Corporation (US-based) and Sany Group (China-based)[126]	Terna Energy USA Holding	Wind farm	Target firm in proximity to a naval weapons systems training facility	2012	Barack Obama
Grand Chip Investment GmbH (Germany-based) and Fujian Grand Chip Investment Fund LP (China-based)[127]	Aixtron, Inc, US business	Semiconductor	Acquirer may misuse the sensitive technology of missile defense system held by the target company	2016	Barack Obama
Canyon Bridge Capital (US-based company, with a Chinese investor as its sole limited partner)[128]	Lattice	Semiconductor	Acquirer is foreign government controlled; Target company involve in technologies with potential military applications	2017	Donald Trump
Broadcom (Singapore-based)[129]	Qualcomm	Semiconductor	Preserving US technology leadership in IT and communication	2018	Donald Trump

Source: (Bian, 2020)

The Congress passed the Foreign Investment and National Security Act (FINSA) in 2007 and in 2018 the process was updated by the Foreign Investment Risk Review Modernization Act (FIRRMA). The new configuration expanded CFIUS's jurisdiction,

> "such that CFIUS now has the authority to review: (1) covered control transactions, which are transactions that could result in foreign control of a US business, (2) covered investments, which are non-passive minority investments of any size in US businesses involved in critical technology, critical infrastructure or sensitive personal data, and (3) covered real estate investments, which are stand-alone acquisitions, leases or concessions of real estate in certain instances, even if the transaction does not involve the acquisition of an existing US business." (Mir, Laciak, & Mommers, 2020).

The criteria recommend for assessing the security threat is presented in Figure 124.

Figure 124. Factors taken in consideration by CFIUS

a domestic production needed for projected national defence requirements;

b the capability and capacity of domestic industries to meet national defence requirements, including the availability of human resources, products, technology, materials and other supplies and services;

c the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;

d whether the transaction is a foreign government-controlled transaction;

e whether the transaction involves a country that does not adhere to non-proliferation regimes or cooperate on counterterrorism efforts, or presents a risk for transshipment or diversion of technologies;

f the potential effects of the proposed or pending transaction on sales of military goods, equipment or technology to any country:

- that is identified by the Secretary of State as a country that supports terrorism, is a country 'of concern' regarding missile proliferation or the proliferation of chemical and biological weapons, or is listed on the Nuclear Non-Proliferation Special Country List; or
- that poses a potential regional military threat to the interests of the United States;

g the potential effects of the proposed or pending transaction on US international technological leadership in areas affecting national security; and

h the potential for national security-related effects from the acquisition of US critical technologies and infrastructure, including energy.

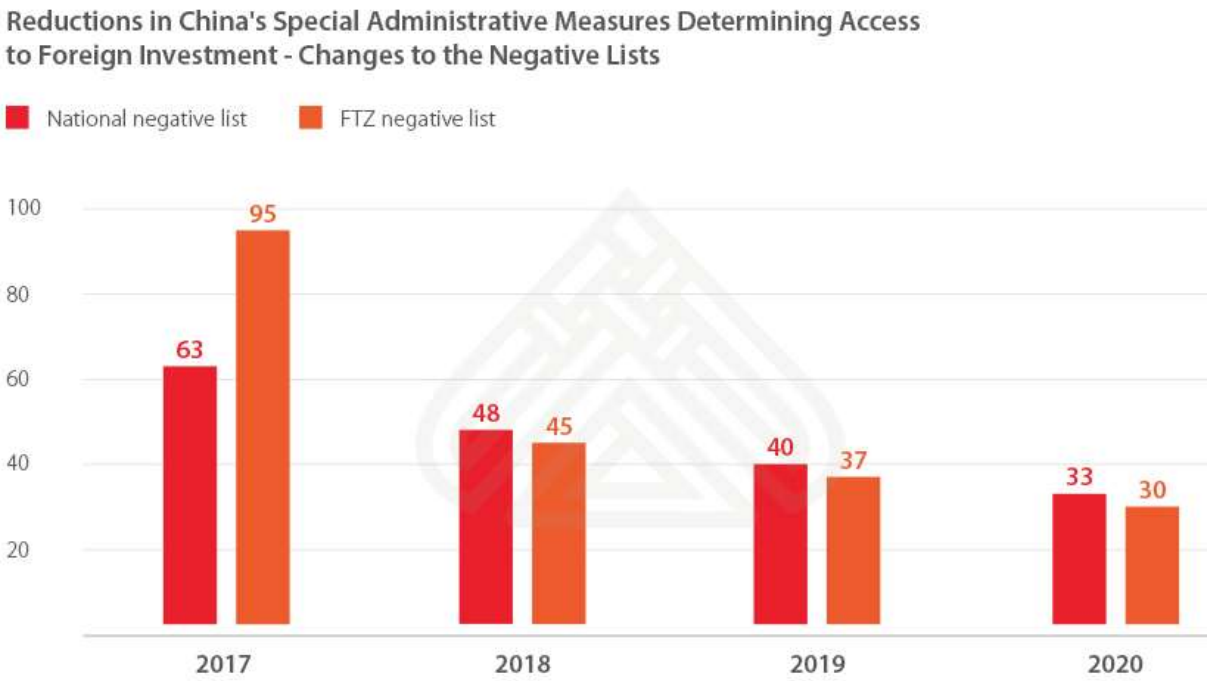
Source: (Mir, Laciak, & Mommers, 2020)

There are also sector-specific limitations for FDI in the USA (Aviation, Banking, Communications, Energy and Shipping).

FDI screening in China

China "did not regulate inward FDI based on national security concerns until the beginning of the twenty-first century" (Bian, 2020). The currently effective national security review regime for cross-border M&A is established by three documents. Two were published in 2011: the *Notice of the General Office of the State Council on the Establishment of the Security Review System for M&A of Domestic Enterprises by Foreign Investors* and the *Provisions of the MOFCOM on Implementing a Security Review System for M&A of Domestic Enterprises by Foreign Investors*. In 2019, it was published the *Foreign Investment Law of the PRC*, guiding the review system for FDI that may affect national security (Bian, 2020). Since 2016, it is in effect a negative-list mechanism, instead of the previous *case-by-case* procedure. Investments in the prohibited list are not allowed and investments in the restricted list are subject to analysis. The negative list is revised (and shortened) every year and the 2020 list prohibits or restricts 33 sectors (figures 125-126) beyond the defence and military sectors.

Figure 125. Evolution of China's negative list



Source: (Zhou, 2020)

Figure 126. Synthesis of 2020 Chinese negative List

Agriculture, forestry, animal husbandry, fisheries	1. New varieties of wheat **(<34%),** and new varieties of corn **(<50%)** 2. Development, breeding, cultivation, and production of reproductive materials (plant, animal, aquac.) **is prohibited** 3. Selection and breeding of genetically modified varieties of crops, livestock, poultry and seeds **is prohibited** 4. Fishing of aquatic products in the sea areas under China's jurisdiction and inland waters **is prohibited**
Mining	5. Rare earth, radioactive minerals, tungsten exploration, mining, and mineral processing **is prohibited**
Manufacturing	6. Publishing & printing **(<50%)** 7. Traditional Chinese medicinal decoction pieces and Chinese medicine confidential prescription products **is prohibited** 8. Vehicle manufacturing companies **(<50%),** except for the special and new energy vehicles, commercial vehicles 9. Satellite TV broadcast ground receiving facilities and key parts production **is prohibited**
Utilities	10. Construction and operation of nuclear power plants **(<50%)**
Wholesale/retail	11. Wholesale and retail of tobacco leaves, cigarettes, re-baked tobacco leaves, and other tobacco products **is prohibited**
Transport, warehousing, and postal services	12. Domestic water transport **(<50%)** 13. Air transport enterprises **(<25%)** 14. Construction and operation of civil airports **(<50%)** 15. Domestic express services provided by postal companies (and to operate postal services) and letters **is prohibited**
Information transmission	16. Telecommunications business **(<50%)** 17. Internet news, internet publishing, audio-visual, Internet cultural operation **is prohibited**
Leasing and business services	18. Chinese legal and law firms is prohibited 19. Market research, radio and television listening and viewing surveys **(<50%)** 20. Social surveys **(<50%)**
Scientific research and technology	21. Human stem cells, gene diagnosis, and therapeutic technology development and application **is prohibited** 22. Humanities and social science research institutions **is prohibited** 23. Geodesy, multiple types of mapping, photography and surveying and multiple geo-sciences **is prohibited**
Education	24. Pre-school, ordinary high schools, and higher education **(<50%)** 25. Compulsory education institutions and religious educational institutions **is prohibited**
Health & social	26. Medical institutions are **limited to joint ventures and cooperation**
Culture, sports, and entertainment	27. news organizations (including but not limited to news agencies) **is prohibited** 28. Editing, publication, and production of books, newspapers, periodicals, audio-visual **is prohibited** 29. Radio and television stations, channels, transmission coverage networks, and related infrastructure **is prohibited** 30. Production and operation of radio and television programs **is prohibited** 31. Film production and distribution companies and cinema chains companies **is prohibited** 32. Auction companies, cultural relics stores, and state-owned cultural relics museums **is prohibited** 33. Performing arts groups **is prohibited**

Source: By the author based on (Wong, 2020)

The Pilot Free-Trade Zones (PFTZ) have a different restriction and screening mechanism, but not less rigid. On the contrary, because PFTZ are more open, they receive closer scrutiny: "given that foreign investment in the PFTZs is now liberalized to a significant extent in general, a more stringent national security review regime is called for in order to provide an effective regulatory means as the last line of defence" (Bian, 2020).

The Chinese Foreign Investment Law (articles 48-74 of Chapter four) asserts that China needs to censor FDI that infringes national security, destabilizes the economy or the social order, or undermines the domestic R&D capabilities. It also identifies 11 factors that must be taken into consideration for revision (Figure 127). Despite growing clarification there is still "no public information regarding how the system works in practice, and no official information has been published so far […]. The review process still remains confidential and secretive" (Bian, 2020).

Figure 127. FDI review factors of analysis in China

(1) The influence on national defence security and sensitive national defence facilities
(2) The influence on the R& D ability of imperative technology concerning national security
(3) The influence on the dominant status of China's technology concerning national security
(4) The influence on dual-use goods and technology diffusion subject to import and export control
(5) The influence on China's key infrastructure and key technology
(6) The influence on the security of information and Internet
(7) The influence on the long-term demand of energy, grain and other key resources
(8) Whether the FDI is controlled by the foreign government
(9) The influence on the stable functioning of national economy
(10) The influence on social public interest and public order
(11) Other factors the Joint Conference deems to be considered

Source: (Bian, 2020)

The revision of the FDI regulation systems reveal that the European FDI regimes are more straightforward, whereas China and the USA maintain ampler discretion to their governments potentially paying the cost of unpredictability: "they do create some hardship for foreign investors to understand the system [… (this)] may put foreign investors in an uncertain and unpredictable situation, thus creating an additional burden for foreign investors in terms of the compliance costs" (Bian, 2020).

4.e. IFDI in Portugal

The UNCTAD estimates for IFDI in Portugal are also accurate on the aggregate (figures 128-129), but unreliable on a directional basis.

Figure 128. IFDI flow in Portugal

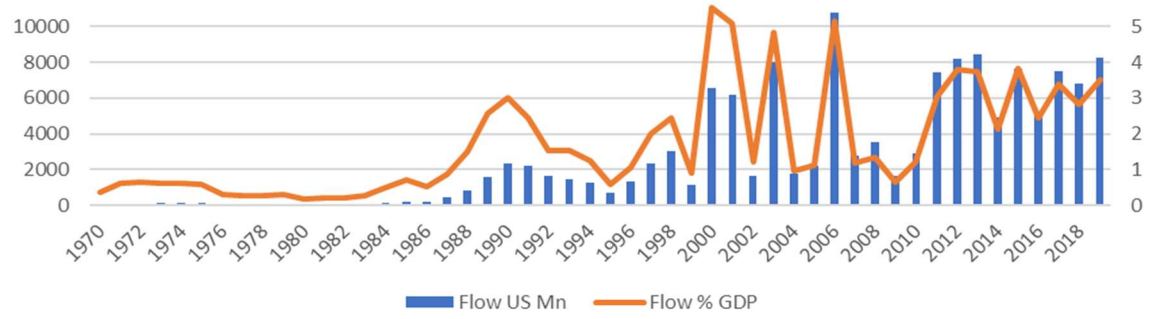
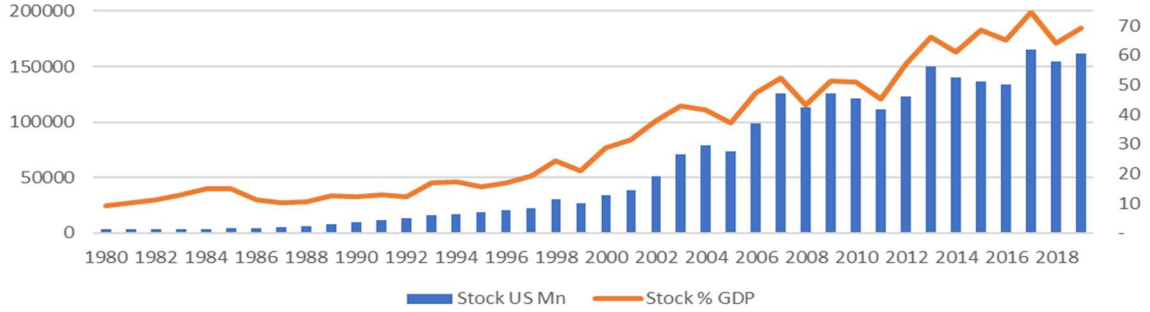


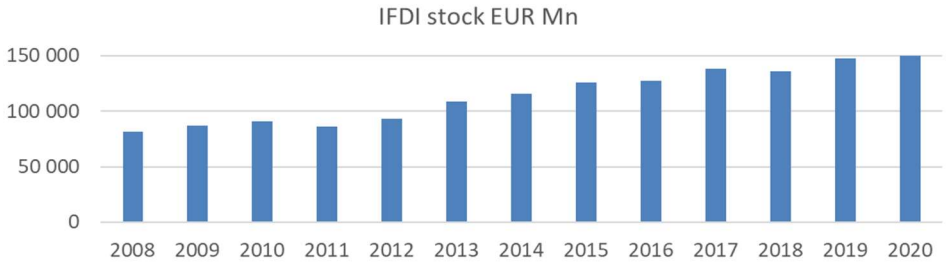
Figure 129. IFDI stock in Portugal



Source: (UNCTAD, 2020)

Banco de Portugal provides similar estimates, which are also used by *Eurostat* (Figure 130).

Figure 130. IFDI in Portugal (Banco de Portugal)



Source: (BdP, 2021)

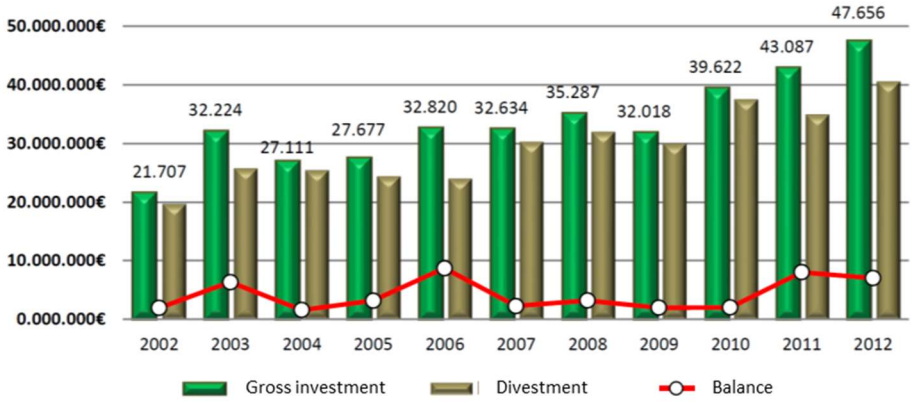
As shown in Figure 128, IFDI was limited until the mid-1980s, partially due to the political instability of the 70s. Only in 1986, with the accession to the EEC, IFDI picked up. The IFDI of the following 15 years was characterized by (1) concentration in financial and insurance sectors (~35 percent of total flows); (2) the services sector reaching the second place (~26 percent) of annual flows in 1990-92; (3) industrials reaching 40 percent of the flows in the

second half of the 1990s; (4) the UK, France and Spain being the main senders, until Belgium and LX gained relevance after 1995 (Moreira & Dias, 2008).

The IFDI of the 1990s is associated with two large-scale automotive projects: Renault and Autoeuropa (a partnership between Volkswagen and Ford). The flows did not accelerate since then, partly because "with the fall of the Berlin wall, the competition to attract FDI increased and Portugal was unable to maintain its position" (Silva, 2015).

In the 2000s, the IFDI flows were more volatile, and Portugal suffered with the increased competitiveness from Southeast Asia and the climate of insecurity since the 9/11. In that decade, the industrial and trade sectors led the flows, whereas the financial services were very volatile. The volatility is more associated with the level of divestments than the reduction of the gross investment, which grew slowly but steadily (Figure 131).

Figure 131. Net IFDI split between gross investment and divestment



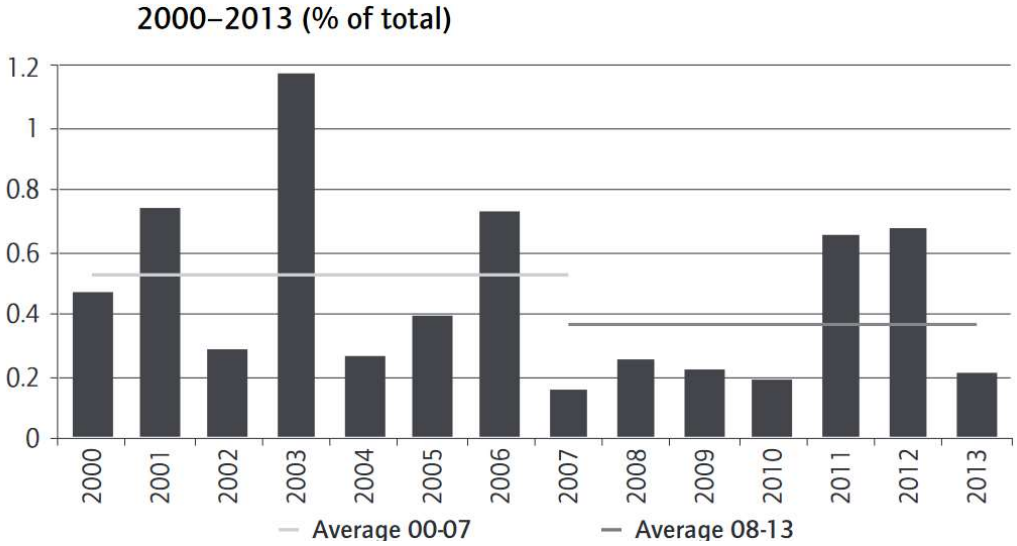
Source: (BdP, 2021)

The divestments are explained by the successive migration of the holdings of the largest companies to NL:

> "This unusually large movement was due mostly to OFDI to the Netherlands, which swung from -€7.5 billion in 2010 to €8.9 billion in 2011. Portuguese firms' relocation of capital to the Netherlands is likely to have created this peculiar pattern of OFDI from Portugal [...] Most, if not all of companies in the PSI-20, the main stock exchange index in Portugal, are thought to have a holding company in the Netherlands. As such, the Netherlands has become the largest inward investor in Portugal and the largest destination for Portuguese OFDI in recent years" (UNCTAD, 2013)

In 2000-13, IFDI flows decreased as a percentage of global flows (Figure 132).

Figure 132. IFDI to Portugal as a proportion of global FDI



Source: (Silva, 2015), based on UNCTAD

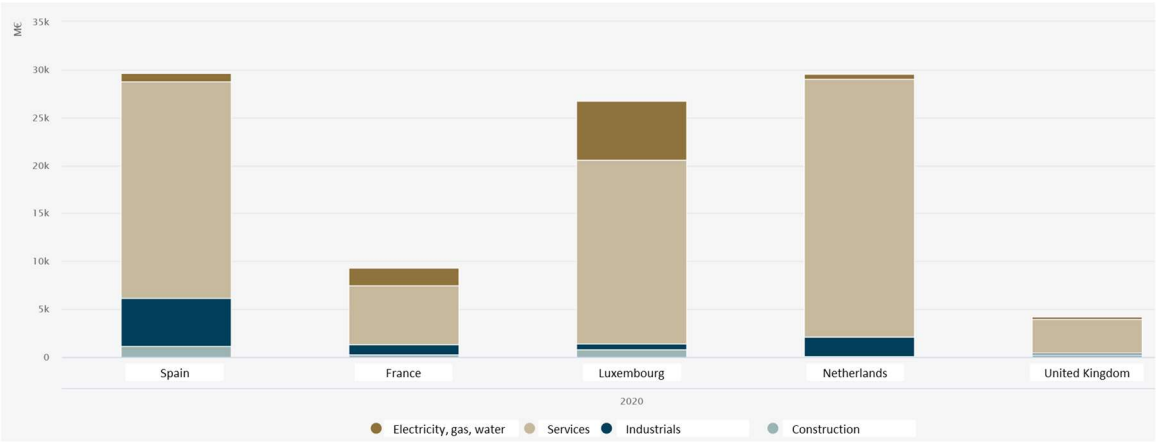
In the previous decades, IFDI in Portugal was generally motivated by three peculiarities: (1) being within the EU but close to the CPLP, (2) having a diverse and qualified labor force at low cost for European standards, and (3) good infrastructures and stable political and regulatory environments. High public debt with low GDP growth, high taxes and increasing salaries have long been the Achilles heel.

More important to this thesis is the performance of IFDI since 2010. The IFDI flow of about 3 percent of the GDP allowed the stock to grow from 45 percent of GDP in 2011 to 70 percent in 2019. This meant a growth of about EUR 50 Bn, of which COFDI represents ~20 percent.

Unfortunately, for the multiple pitfalls of FDI bilateral estimates, the official flow of COFDI is not accurate, biased by a disproportionate share of some EU origins which worked as intermediaries: “Chinese investments in Portugal have been prominent in the crisis period, especially since 2011 and the privatization process, estimated at around 6 billion euros by the end of 2014 (Le Monde 2015), but we find no trace of similar amounts in national statistical sources” (Silva, 2015).

Figure 133 shows the official top 5 IFDI investors in Portugal, where it seems evident that a part of COFDI is included in the Luxembourg origin. *Banco de Portugal* (under)estimates the COFDI stock to be EUR 880Mn in 2014, EUR 1.27Bn in 2015, EUR 1.75Mn in 2016, EUR 2.15Bn in 2017 and EUR 2.52Bn in 2018.

Figure 133. Banco de Portugal's IFDI stock breakdown per sender country



Source: (BdP, 2021)

IFDI determinants changed since 2008:

> "during the crisis and later 'austerity' policies, economic growth, rising GDP per capita or expanding markets… were certainly not the motives for attracting FDI inflows… On the contrary, in the search for cash resources, privatization programs – usually involving the sale of public companies at below market value (in normal conditions) or the sale of indebted firms with potential, market power or technology – are much more relevant FDI determinants" (Silva, 2015).

In May 2011, the Government committed to the sale of multiple companies (EDP, REN, ANA, CTT, CP Carga, etc.): "the government's objective of obtaining the maximum cash revenues for the state in the short term often prevailed over any other purpose, no matter what a given privatization's impact on the economy or the consequences for the firm itself might be in the long run" (Silva, 2015). Despite the good intentions, which seem unquestionable, there remains the notion that the Government ignored important economics wisdom: "a number of studies have demonstrated that asset acquisitions are likely to have a negative impact on employment [… (and)] this is even more true with regard to public companies that have not yet been

restructured particularly if costs reduction is of particular importance to the new owner" (Silva, 2015). Moreover, as mentioned, the *Immiserizing growth* theorem proves that IFDI in monopolies is undesirable. In the 2010s, Portugal was able to attract FDI but not of the most desirable nature.

Informa, a Portuguese operation of *Dun & Bradstreet* provides insights based on firm-level data. Its 2018 report describes the profile of FDI investors and allows for five main conclusions. First, there are 9,705 foreign-owned companies, and the foreign capital controls the 81 percent of them; among the 7,866 foreign-controlled, 55 percent have Spanish (2,040), French (738), English (590), American (540) or German (425) control, and 74 percent of the volume comes from Spain, France, Germany, USA and China; second, the foreign-owned companies are 3 percent of the companies in the country, but 47 percent of the turnover, 72 percent of the banking product, 92 percent of the insurance premiums, 62 percent of the exports and 25 percent of the labor force. Third, 64 percent of the large corporations (>EUR 500 Mn) have foreign investors, but only 35 percent of the midsized (>10 Mn), 13 percent of the small (>2 Mn) and 2 percent of the micros (<2 Mn) do. Fourth, most of the foreign-owned companies have local management. Finally, the different origins focus on different sectors, with German FDI concentrated in industrials (56 percent), the UK and the USA concentrated in wholesale (41 percent and 39 percent respectively). Most of the retail is French or Spanish, representing 27 percent and 21 percent of their FDI respectively (Informa, 2018).

Looking ahead, EY provides some insights on what the strategic advantages and potential weaknesses for Portugal are attracting and retaining IFDI. Portugal allows for a high standard of quality of life, provides a stable social climate and has good telecom and logistical infrastructures. On the improvement side, it can invest more on high-tech and innovation, and in developing its education and skills. Additionally, high taxation seems to be an important source of concern for foreign investors (EY, 2020).

5. Chinese Economic Statecraft

5.a. Chinese economic statecraft as different from political warfare

Understanding Chinese economic statecraft, requires distinguishing it from Chinese political warfare. The *political warfare* concept was introduced by Kennan, in an attempt "to describe and assess the dark arts of Soviet subversion" (Yoshihara, 2020). It means the usage of all instruments of national power, short of violent military tools against rival governments and societies to realize political ends, i.e., persuading, subverting, intimidating, and coercing the enemy to influence its behavior (Yoshihara, 2020). The covert, corrupt and coercive nature of such practices put it in the domain of foreign interference, rather than foreign influence (Parello-Plesner, 2018).

Nevertheless, it is important to review the hypothetical undertakings of Chinese political warfare since they may run tangent to economic statecraft. It is also relevant to remember that other powerful nations (including the USA) are also actively engaged in political warfare.

According to China's political warfare literature, China's interference has been mostly pursued through the media, the academia, the think tanks, the Chinese diaspora, and less frequently via political party financing: "In the USA, CCP interference and influence operations are aimed at politicians, businesspeople, academia, the media, and Chinese diaspora communities" (Parello-Plesner, 2018).

These activities are frequently called United Front work, which is related but not limited to the workings of the United Front Work Department. The USA Government believes that China is pursuing an all-of-nation long-term strategy that involves military modernization, influence operation and predatory economics to shape the environment to its interests (Yoshihara, 2020). This thesis does not aim to dissect the degree to which these practices are prevalent in today's Chinese foreign policy, but it must take note of what is being published about them.

The first consideration to be made is about the merits of the effort. In a handful of publications, prestigious institutions have been calling the public's attention to the hypothesis that China may be manipulating the Western societies in several nefarious ways. Such publications include (Diamong & Schell, 2018), (NED, 2017), (RSF, 2019), (Parello-Plesner, 2018), (Lloyd-Damnjanovic, 2018) and (deLisle, 2020), which includes (Yoshihara, 2020). Because of the severity of the accusations, the scrutiny of this topic is necessary and critical.

The second consideration is that the evidence presented in these reports is less than overwhelming and the argument is a bit speculative, to the point that the credibility of the effort is undermined by the anecdotal shallowness of the materials. If the accusations are legitimate, there must be better sourcing to be found. Most of the citations circle back to three authors - Bates Gill (USA), Clive Hamilton (Australia) and Anne-Marie Brady (NZ), who have a passionate perspective evidenced by the aggressive tone of their writings. Moreover, there is a tendency to extrapolate the experiences from Australia, NZ and Taiwan to other Western countries, which is stretched from an academic standpoint. Illustratively, the Jamestown Foundation published surveys about CCP influence in close neighbors such as Japan and Singapore, and found little evidence of the dynamics similar to those described by the above-mentioned authors: "CCP political warfare activities against Japan are less readily apparent – or at least, not as openly discussed within the policy community of Japan, let alone the general public. Additionally, the effects, at least on the surface, appear to be not as evident or severe" (Hsiao, 2019).

The third consideration is to explain the mechanics presented in the accusations, irrespective of their robustness. The most inflamed book is probably *Hidden Hand: Exposing How the Chinese Communist Party is Reshaping the World*, by Clive Hamilton & Mareike Ohlberg, which is a sequel of Hamilton's *Silent Invasion: China's Influence in Australia*. It argues that China is pursuing a "subtle and multipronged program of global thought management" to enable a

strategic rebalancing, after diagnosing the need for "a discourse power and an image to match its status" (Hamilton & Ohlberg, 2020). The credibility of the book is jeopardized by the numerous tales created (without meeting the scientific bar) to argue that many respectful and powerful Western individuals and institutions are in "China's pocket". These include Stephen Schwarzman (CEO of Blackstone), Dominic Barton, (CEO of McKinsey & Co), Ray Dalio (CEO of Bridgewater), Michael Bloomberg (Governor of New York), Henry Paulson (former Secretary of US Treasury), Justin Trudeau, Joe Biden, the Brookings Institution, the Chatham House and the Berggruen Institute, to name just a few.

In the media realm, China has been acquiring and borrowing vehicles:

> "The CCP has been strategically using foreign media to place its own content and also influencing coverage in Western media, through persuasion techniques, financial incentives, or threats to uncooperative outlets and foreign correspondents. The CCP has partnered with some foreign outlets to spread positive news about China." (Hamilton & Ohlberg, 2020).

About Portugal, it mentions the acquisition of Global Media by KNJ (which is misspelled in the book as "KNG") and a "media cooperation agreement as part of its BRI deal in 2019, which commits parties to organize mutual visits of news agencies, carry out joint media coverage and hold seminars as well as training for journalists" (Hamilton & Ohlberg, 2020). The paid advertorial supplements, the acquisition of some news outlets (or time slots), and the all-inclusive trips to China by several journalists are the main focus of criticism.

In terms of academic manipulation, China has created several ways to finance Western universities, and then turned its financial support contingent on the avoidance of opposition to China's interests. These include the Confucius Institutes, the executive trainings, and the publishing of books in China, among other types of cooperation:

> "The western tradition of free intellectual inquiry, of following the truth wherever it leads, has always faced corruption by money; in recent times, some of that corruption has followed Chinese money […] If a university runs research projects with Chinese

> counterparts for profit, or depends on tuition fees from PRC students, this creates structural incentives to stay on China's good side" (Hamilton & Ohlberg, 2020).

Lloyd-Damanjanovic argues that over the past two decades, PRC diplomats in the USA have infringed on the academic freedom by "complaining to universities about invited speakers and events", pressuring "faculty whose work involves content deemed sensitive by the PRC", "retaliating against American universities' cooperative initiatives with PRC partner institutions", and "probing faculty and staff for information in a manner consistent with intelligence collection" (Lloyd-Damnjanovic, 2018). At the same time, some PRC students have been "demanding the removal of research, promotional and decorative materials involving sensitive content from university spaces", "demanding faculty alter their language or teaching materials involving sensitive content on political rather than evidence-based grounds", "interrupting and heckling other members of the university community who engage in critical discussion of China", "pressuring universities to cancel academic activities involving sensitive content", "monitoring people and activities on campus involving sensitive content", "probing faculty for information in a suspicious manner", and "engaging in intimidation, abusive conduct, or harassment of other members of the university community" (Lloyd-Damnjanovic, 2018).

There are also accusations of party financing, both covert and overtly. An Australian "ABC report in August 2016 showed that between 2013 and 2015, PRC-linked companies and individuals donated more than A$5.5 million to Liberal and Labor Party accounts, making them the largest foreign-affiliated donors to these two parties" (Gill & Jakobson, 2017). In the USA,

> "China seeks to identify and cultivate rising politicians. Like many other countries, Chinese entities employ prominent lobbying and public relations firms and cooperate with influential civil society groups […] In some rare instances China has used private citizens and/or companies to exploit loopholes in US regulations that prohibit direct foreign contributions to elections" (Diamong & Schell, 2018).

The political warfare mechanism which has the most important overlap with economic statecraft is the acquisition of political influence via local corporations established in the target country. The American corporate sector influence has been analyzed "through three lenses: (1) the use of business-related United Front organizations in the USA; (2) Chinese companies operating in America, and (3) Chinese pressuring and manipulation of American companies as vectors of influence" (Diamong & Schell, 2018). Among these, the third is the most relevant for our analysis. The Australian case showed that prohibiting foreign nationals to contribute to elections does not prevent the political party financing, which can happen through lobbying and indirect contributions "via US subsidiaries, and the hiring of former senior government officials" (Diamong & Schell, 2018).

Irrespective of semantics, China's sharp power (being it through the academia, the media, the political party financing, etc.) is supposedly taking advantage of the glaring asymmetry of openness between democracies and the China's autocratic regime, with the ultimate goal of reducing the foreign resistance to its rise (NED, 2017). And because China is not a military ally, this threat must be taken seriously.

The final consideration is also significant criticism to these allegations. One work which unpacks the discursive construction of a European *China Threat* narrative by European think tanks is that of Rogelia & Tsimonis, from the King's College London: "despite having no decision-making authority, think tanks participate as securitizing actors in the process of idea formation and bidding, articulating a securitized frame of reference for policy makers" (Rogelia & Tsimonis, 2020). First, the *China Threat* securitizing attempt is characterized by a distorted representation of Chinese economic activities abroad, including those falling under the BRI, via "a politicization of Chinese investments through a downgrading or denial of the decentralized decision-making agency of the Chinese and European actors involved" (Rogelia & Tsimonis, 2020). Second, the narrative distorts the notion of European politics where pluralism becomes

a weakness and disagreement becomes dissent, promoting a view of the EU where ”responsible” core countries must contain the periphery’s ”opportunism”, and that “European unity is undermined over disagreement on how to engage China”. Third, the *othering* of Chinese actors and their *enablers* as agents of hostile political, social and economic order (Rogelia & Tsimonis, 2020). It argues that

> “some reports reveal a polemical attitude to an issue that requires careful, fact-based analysis…instead, we end up tilting at windmills, chasing dragons that do not exist. The result is not only a sacrifice of analytical depth, informed evaluation, and thorough identification of actual opportunities and challenges; exclusively assigning political motives to Sino-European interactions leads to the practice of wholesale securitization of everything and everyone supportive of developments accompanying Chinese investments” (Rogelia & Tsimonis, 2020).

The assumption that the governments on the periphery are either ill-intentioned or naive to address the Chinese challenge, followed by the corollary that this “calls for extraordinary measures from stronger member states and supranational institutions on behalf of the EU” (Rogelia & Tsimonis, 2020) can be perceived as appalling by the elites and the populations of those peripheral countries.

5.b. Learnings from the Chinese economic statecraft literature

Albert Hirschman was the precursor in the analysis of economic statecraft, and in his analysis of foreign trade as an instrument of national power he made a crucial point: "Hirschman uses Nazi's Germany's trade relations to illustrate how asymmetric trade relations create political gains for the larger state" (Segal, 2007). The importance of asymmetry is cornerstone to understand Chinese economic statecraft and the role of COFDI in it, because no one has ever controlled so much wealth as the CCP controls today:

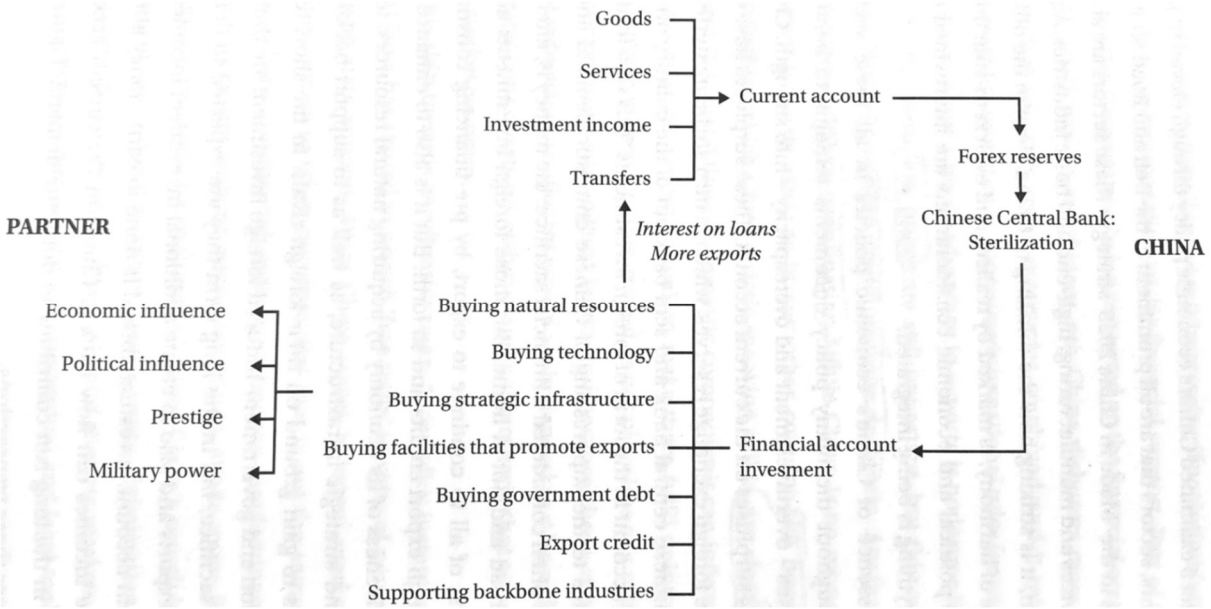
> "When it comes to outbound global investment, no government has more working capital at its disposal, or more tools to channel it, than the PRC. Many of these tools are novel – either in kind, by order of magnitude, or both – and found exclusively or almost exclusively in China." (Blackwill & Harris, 2016).

Many authors argue that "Beijing's influence around the world is no different to that of any other country", but others respond that "while not everything the Party does in this respect is unique, the scope, degree of organization, and eagerness to use coercion distinguish the CCP's actions from other nations' diplomatic activities" (Hamilton & Ohlberg, 2020).

It is important to remember one crucial point that comes out of this thesis' *Primer on China*: the essence of China's economic policy "remains to bend its weaknesses – overinvestment and overcapacity – into strength" (Holslag, 2019). Holslag was masterful in illustrating the self-enforcing loop which makes the Chinese investment abroad an inevitability with multiple consequences, which are simultaneous and impossible to unravel. China generates massive surpluses on the current account and those create gigantic FX reserves. China decides to sterilize these flows by the Central bank and send them back abroad in the form of COFDI and export credit. What looks like a short-term sacrifice (since this money is not spent at home), in the long term is "expected to defend Chinese exports and also to create additional investment incomes on the current account" (Holslag, 2019). China acquires natural resources, technology, strategic infrastructure, facilities that promote exports, Government debt and supports exports

and backbone industries. These investments yield further surpluses in a virtuous circle, but also generate economic influence, political influence, prestige, and military power (see Figure 134).

Figure 134. Summary of China's foreign economic policy by Holslag



Source: (Holslag, 2019)

China appreciates all these consequences, no matter if some Chinese care more about one, or if some foreigners worry more about another. Therefore, the discussion in this chapter is not about "if" or "why" China uses economic statecraft, but rather "how" China does it.

In the West, it may sound paradoxical that China wants simultaneously to be more feared and less feared, but that is inherent to the long-lasting concept of *benevolent ruler*. Lee Kwan Yee, the charismatic Singaporean leader, who was himself frequently portrayed as a benevolent dictator, was probably the foreigner with most influence over the last several generations of Chinese leaders. When asked if China wanted to become the world's most powerful nation his answer was straightforward: "Of course. Why not? How could they not aspire to be number one in Asia and in time in the World?" (Allison, 2017).

Another point that must be recalled from the previous chapters is the inevitability of the role played by the Chinese State. Analyzing the present and future of China without taking the centrality of the CCP as a given is inadequate. Not only because of China's history and its

organizing superstructure, but also because this is what today's high-income countries did in the past: "In view of the extremely uneven nature of international business competition, it is unsurprising that China attempted to nurture national champion firms through state-led industrial policy measures. In different ways, this is exactly what all of today's high-income countries did in the past, from the late eighteenth century onwards" (Nolan, 2012). In fact, "China's socialist legacy and its state-led development model has left China's leaders with enormous control over its economy – even if that control has real limits" (Reilly J. , 2013). We need to understand the conditions under which the CCP can steer its economic agents in pursuit of political objectives. Assuming a *puppet-master* type of control is improper.

According to the author of this thesis, the current state-of-the-art Chinese Economic statecraft literature can be found in the writings of two key contributors: William Norris and James Reilly. Together, their thinking incorporates most of the existing fact-based knowledge.

In *Chinese Economic Statecraft: Commercial actors, grand strategy and state control,* Norris defines economic statecraft as "the State's intentional manipulation of economic interaction to capitalize on, reinforce, or reduce the associated strategic externalities". China, like many Western countries, frequently intends to influence commercial actors in pursuit of its strategic interests. These attempts go beyond Public Chinese commercial actors to private and foreign commercial actors. Sometimes with success, sometimes not. Discussing if China can or cannot turn its economic power into political influence is not the right question to ask. Instead, this work analyzes the *conditions under which* China is more successful in practicing economic statecraft. States do not conduct economic relations with each other. Such relations are always carried out by concrete commercial actors (just like states do not wage wars – armies do).

The cornerstone of this work is the notion that China's ability to *control commercial actors* is what determines the level of success of Chinese economic statecraft. In other words, control vs. no-control is the dependent variable (DV). To explain the DV, Norris developed a framework

composed of five independent variables (IV) which are applied to ten case studies of Chinese economic statecraft.

The two most important IV are *State unity* and *Goal compatibility*. In one extreme, when all governmental institutions are aligned regarding one foreign policy issue and the objectives of the commercial actor that needs to be controlled are perfectly aligned with those from the state, then control is guaranteed. On the opposite side, when there is misalignment among state levels (e.g., Municipalities and Central Government) and the objectives of the commercial actor are opposite to those of the Government, this creates Principal-Agent[10] challenges.

The other three IV become relevant when *State unity* and *Goal compatibility* are not simultaneously present. These are *market structure* (monopoly vs. oligopoly vs. fragmented market), *relative resources* (e.g., know-how of the state vs. commercial actor) and *reporting relationship* (does the state own the commercial actor? Does the state appoint the management team? Does the state finance the commercial actor?).

The ten case studies are organized in three categories, according to the foreign policy initiatives in question: (1) securing strategic raw materials; (2) cross-strait economic statecraft; and (3) China's SWF.

It was value-adding for Norris to incorporate the concepts of security externalities in the definition of economic statecraft: the notion that a given transaction may produce effects that are not fully internalized among the parties that are directly conducting the transaction. Such effects may include the transfer of sensitive technology, loss of strategic industries, concentrated supply/demand dependence, to name just a few.

Another interesting insight is that the success of CCP's push for the *Going Out* policy can be seen as proof that effective central command and coordination is sometimes possible. At the

[10] Principal-Agent theory was first developed in the 1970s (authorship is still discussed to this day). It refers to the dilemma faced by one agent which must decide on behalf of another, particularly when their interests are not absolutely aligned.

same time, such success requires a lot of very high-level attention. The implication is that senior state levels can only devote energy to promoting critical initiatives thus paying little attention to small/midsize specific COFDI cases, such as those involving most Portuguese companies.

Norris concludes that if China wanted to reduce the concerns about its rise, it should provide reassurances such as tying its hands ("spike the guns") on what concerns direct command over commercial actors such as SWF. It also notes that China does not seem willing to go down such path, resulting in the curious outcome that inefficiency mounts exactly on those strategic sectors which economic statecraft attempts to protect.

This book's success opened the road for more work investigating the relationship between commercial actors at micro-level and the economic elements of grand strategy at state level. The present thesis continues down this path and evaluates all cases of COFDI in Portugal, with three differences. First, it focuses specifically on FDI. Second, it goes beyond the relationship between the Chinese State and the first-level (Chinese) commercial actors, also investigating the relationship between the Chinese commercial actors and the second-level foreign commercial actors. Finally, it analyzes COFDI in Portugal, which is an understudied scope, also because no relevant attempt of political interference on this field is known to date: "it is perplexing that so little debate has taken place on the issue of China's presence in the country… Unlike their counterparts in the Czech Republic and Greece, for example, Portuguese academics so far have not taken part in a public debate on Chinese FDI" (Corre, 2018).

In another publication, Norris has emphasized the role of two phenomena – *bolstering* and *strategic transfer* – in China's economic statecraft in the USA. The first refers to the "security externalities that result when economic interaction with the USA makes China's economy stronger", whereas the second refers to "security externalities that results from economic interaction which enhances a target state's war-making capabilities through the acquisition of

strategic goods, expertise, resources or dual-use, and/or dedicated military technologies" (Norris W. , 2017).

In *China's economic statecraft in Europe* (2017) Reilly analyzes China's economic statecraft in Europe since the Financial Crisis (2009). According to him, "economic statecraft is the purposeful use of economic resources by political leaders to exert influence in pursuit of foreign policy objectives" (Reilly, 2017). The paper starts by acknowledging that concerns about the strategic implications of economic statecraft in Europe are mounting within the academic community, but the coverage of the subject lacked depth and substance. Building on the works of (Keohane, 1986) and (Drezner D. , 1999) Reilly identifies three strategies – *specific reciprocity, diffuse reciprocity* and *strategic engagement* – upon which China relies when attempting to convert economic power into political influence in Europe. He then evaluates the methods and outcomes of these strategies when applied by China in the EU.

The first strategy – *specific reciprocity* – refers to the exchange of items of equivalent worth by specific partners, in a strictly delimited sequence, coming with a clear *quid pro quo* (Drezner D. , 1999). This contrasts with the second strategy – *diffuse reciprocity* – in which the definition of equivalence is less precise, one's partners may be viewed as a group, and the sequence of events is less narrowly bounded (Keohane, 1986). Either of the two reciprocity strategies can be *positive* (offering benefits) or *negative* (punitive). Punitive measures are only likely to have some degree of success when dealing with only one partner, ideally much weaker, and if applied to a topic which is much more important to the inflicting country than to the target country.

The *specific reciprocity* strategy is analyzed considering Tibet, namely the attempts to prevent European leaders to meet with the Dalai Lama. China regards its sovereignty over Tibet as a principle of the utmost importance, therefore viewing as offensive any interaction with the Tibetan Government in exile. China's mixing of carrots and sticks through tight reciprocity

successfully influenced two major European leaders (the French and the British) while sending a powerful deterrent signal across Europe (Reilly, 2017).

The (positive*) diffuse reciprocity* strategy is evaluated based on the case of the MES status. The WTO employs different procedures in analyzing dumping cases depending on whether the country in question has such status. While China believes that this status should have been awarded automatically in 2016, several EU countries oppose it. The paper points out that China has failed to influence EU member states to endorse MES recognition through a positive *diffuse strategy*.

The third strategy – *strategic engagement* – has been employed to build closer institutionalized linkages and reassure Europeans of China's benevolent intent. The paper evaluates the case of China's support in rescuing several EU countries (including Portugal) at the height of the 2008-09 financial crisis. According to the *Financial Times,* the visit of President Hu Jintao to Portugal was followed by a "massive influx of investment amidst a looming sovereign debt crisis" which "offered a crucial sign of support for the beleaguered Portuguese Economy" (Wise, 2010). As George Soros put it: "China saved the Euro" (White, 2015). At the institutional level, this strategy seemed to have borne some fruit. The EU-China Strategic Partnership progressed in the last decade but the sentiment of the EU population towards China gradually worsened.

Reilly concludes that reciprocity strategies which aim to leverage short-term opportunities undermine China's aspirations to be perceived by the EU as a benevolent partner, particularly through the negative impact on public opinion. For him "China's economic influence in Europe may thus be far less worrisome than most popular writings suggest" (Reilly, 2017). Reilley suggests a clear distinction between the high-level influence that China can aspire to in weaker neighboring countries (such as Cambodia, Myanmar or Sri Lanka) comparing to much lower levels of influence in European countries or Australia. Following Norris' line of thought, it is, in practice, extremely hard for China to influence foreign commercial actors.

Reilly's 2021 book *Orchestration: China's economic statecraft in Asia and Europe* builds upon the previous papers but goes further and deeper. It provides a comprehensive analysis of the economic statecraft theory, an historical analysis of Chinese economic statecraft culture and several new case studies, including several from Europe. The notion that a country's domestic political economy exerts a powerful influence upon how that country engages in economic statecraft is central to the book. He disagrees with Baldwin's notion that the success of economic statecraft cannot be measured. He proposes that success is measured by the actors' ability to realize the goals they set for themselves and distinguishes between coherent implementation – actors advancing Chinese leader's foreign policy objectives – and influencing target states (Reilly J. , 2021). Influence comes from political affinity (the target identifies with the sender's interest) or policy accommodation (to adopt measures desired by the initiating state). Moreover, influence requires causality, intentionality, and goal attainment.

One very important contribution to the theoretical debate about economic statecraft is the incorporation of the concepts of indirect governance: orchestration and delegation. This move helps exploring how the character of state institutions and state-society relations shape a state's approach to designing and implementing economic statecraft. It helps understanding why more sectors/agencies under the control of the state do not necessarily translate into more absolute control, because it increases the complexity of the orchestration. According to Reilly, "Orchestration theory was created to describe how policymakers identify subordinate actors who share their basic priorities, and then support and encourage these agents to act in ways that simultaneously advance both policymakers' and their own goals" (Reilly J. , 2021). The orchestration approach followed by China

> "integrates three core elements: the nesting of orchestration tactics within its hierarchical structures; the use of lucrative tournaments designed to attract eager participants while facilitating oversight and discipline; and designing economic statecraft initiatives to maximize interest alignment between central leaders' foreign policy goals and the interests of key implementing actors" (Reilly J. , 2021).

This approach, “places Xi Jinping in the conductor’s stand, bolstering rather than undermining state authority over the economy […] maintaining a central role for the state and its constituent actors in mobilizing a broad array of domestic actors, while relying upon diverse techniques in pursuit of multiple policy goals” (Reilly J. , 2021).

Reilly reflects upon the pitfalls of theories focusing on reciprocity strategies of economic statecraft. While the rationalist view presupposes that awarding carrots and sticks does not alter the target country’s preferences, the empirical evidence favors a constructivist view which suggests that economic statecraft instruments have an impact on target state’s preferences. An obvious example is a situation in which the usage of economic sanctions severely mitigates the future potential for collaboration because of diminished political affinity. Likewise, strategic engagement organically generates vested interests which will tend to promote diplomatic accommodation within the target state.

The recent history of Chinese economic statecraft in Europe provides significant evidence that strategic engagement, even without explicit elements of reciprocity expectation, may lead instead to more anxiety and less political affinity. This book includes one chapter focusing on Western Europe and another on Central and Eastern Europe. It notes that China was successful in promoting economic engagement with several countries with a strategy which mixed COFDI with the purchase of Government debt and differentiated access to the Chinese home market. Agency challenges were solved by combining proactive leadership by the central Government with preference alignment (of other public and private actors). The success in driving the economic actors did not translate into actual policy accommodation (except for the Dalai Lama case). On the contrary, “this outcome, though frustrating for Beijing, suggests that Europeans’ surging anxiety over China’s economic presence is largely overwrought. As I argue elsewhere, economic engagement with China yields far more benefits for Europeans with far fewer political costs than most popular analyses assume” (Reilly J. , 2021).

In a nutshell, as Pardo argued, "in common with other users of economic statecraft, China may use economic statecraft in three ways: by directly linking economic ties to changed behavior in the target state; using economic interdependence to constrain the behavior in the target state; and using economic interdependence to transform the foreign policy goals of the target state" (Pardo, 2018). Wong has argued that China does so with two types of inducements: instrumental and societal. The first are "the provision of economic benefits linked to specific conditions and political outcomes – buy over top political elites", whereas the second are "economic benefits provided more broadly to general public and business/interest groups – alters the balance of domestic political interests" (Wong A. , 2017). His analysis concludes that China's economic statecraft has limited effectiveness but is mostly (negatively) correlated with the public accountability of the target country (i.e., instrumental carrots focusing on benefiting a selected group of elites may yield quick political dividends in countries with low public accountability). China has different approaches to countries with different income levels:

> "In poor countries China cajoles elites by promising loans that allow them to commission infrastructure and thus to try to increase the enthusiasm of interest groups, like ports, retailers, logistics companies and real estate developers, which have an interest in cheaply imported Chinese goods and Chinese capital, as well as that of large multinationals with a strong presence in China" (Holslag, 2019).

In general, "Chinese leaders prefer economic carrots to sticks as a means of exercising diplomatic influence. Incentives offer mutual economic benefits and build closer political ties. Beijing's calculation is that economic engagement will eventually produce desirable changes in targeted countries" (Pu, 2017). Nevertheless, "despite the emphasis on positive incentives, China remains willing to deploy punitive economic measures in defense of its national interests […] China tries to exert influence through reciprocity, whereby desired behavior is rewarded while undesired behavior is punished" (Pu, 2017).

Although frequently voicing dislike for sanctions, China is reasonably effective in steering its domestic demand. On the one hand, it can influence consumer habits: "Beijing has shown itself

capable and willing to redirect the consuming habits of its domestic market to punctuate a political disagreement". On the other hand, "China has subtler ways of depressing imports as a means of registering political grievances – *ad hoc* customs measures affecting imports, retaliatory tariffs on a politically sensitive good or set of goods, new and arbitrary regulations on foreign firms and importers" (Blackwill & Harris, 2016).

Lampton identifies five main forms of Chinese economic power expression – power of the buyer, of the seller, of the investor, of the donor, and of the innovator. He pinpoints that, in the case of China, the power of the investor and that of the donor tend to be considered jointly because the "distinction between 'private' business and state purposes often is blurred" (Lampton, 2008).

As Feigenbaum points out, "because China's economic interactions with the world are so diverse now, blunt coercion is one of just five types of leverage – and not necessarily the most important" (Feigenbaum, 2017). First, *passive* leverage, "essentially lets China's size, weight and market power do the talking". Second, *active* leverage, goes beyond that, i.e., China tries "to take a direct hand in shaping the rules and norms in other countries". Third, *exclusionary* leverage is about "granting or denying access to China's own domestic market in an effort to ratchet up the pressure". Fourth, *coercive* leverage "is even more direct. Here China doesn't simply wield access to its market as a weapon but attempts to inflict discrete punishments tied to discrete offenses". Finally, *latent* economic leverage is about "the coercive cards it holds but chooses not to play" (Feigenbaum, 2017). Looking at the whole experience, it becomes apparent that China has tried all sorts of tactics with all sorts of outcomes. For this reason, we conclude that if there is a Chinese playbook of economic statecraft, it is still *in the making*.

Regarding Taiwan, China employs all sorts of efforts to avoid *de jure* independence and move towards political integration. The overall strategy seems to include diplomatic isolation, "increased economic integration across the Strait, increased cultural contact, and military

deterrence" (Lampton, 2008). China is said to follow a *5M* approach of economic statecraft and social penetration: "money, manpower exchange, misinformation, mooching (cultivating compradors) and magnifying (propagating the *Chinese Dream*)." (Chang & Yang, 2020).

As mentioned, China's influence and interference in Australia and NZ have been regarded as grounds where China's political warfare (including its economic statecraft components) is evident and became reference cases for those arguing in favor of slowing down the West's engagement with China. Nevertheless, and despite the loud debate on the public space, NZ remains very close to China, and Australia has certainly not turned its back on it. Rein, who categorizes countries in three levels regarding their relationship with China (*Hot, Warm* or *Cold*), ranks NZ as *hot* and Australia as *warm* (Rein, 2018).

In the same category of NZ, Rein includes Laos, Cambodia, Ethiopia, Pakistan, Greece, Hungary, Venezuela and Iran, whereas on the warm category he includes Thailand, the UK, Germany, Australia, Indonesia and France. The cold partner's list includes countries like Philippines, Vietnam, Mexico, Belize, Burkina Faso, Nicaragua and India.

Canada moved from cold partner under PM Stephen Harper to warm partner under Trudeau. While Canadians are generally aware that "Canada's chances of continuing the last seventy years of economic and security dependency on the USA look less and less secure" and that "engagement with China cannot and should not be avoided", there is a growing perception that "if Canada does not reassess and rework its approach to Beijing, this country may be steamrolled by the new juggernaut of history" (Manthorpe, 2019).

China has been willing to flex its economic muscles against several important neighbors when its security interests are threatened. In 2017, "at the invitation of South Korea, the USA began to install the Terminal High Altitude Area Defense (THAAD) anti-ballistic missile system […] China objected strongly, fearing that THAAD's advanced radar system could be used to spy on it and neutralize a Chinese response to an attack" (Hamilton C. , 2018). China took 43 retaliatory

measures against South Korea in response. Like in Australia, China's impact on South Korea's Tourism industry is overwhelming, and the ban of group tours is sufficient to collapse it. Three months into the turmoil, South Korea suspended the installation of THAAD.

Seven years earlier, after a Chinese ship captain was arrested in the context of a maritime dispute, China shutdown exports of rare earth oxides to Japan, after which Japan released the captain. Additionally, "in 2012, 150 containers of bananas were left to rot on Chinese wharfs because the Philippines objected to Chinese fishing boats encroaching on Scarborough shoal. Around 200,000 banana workers were affected" (Hamilton C. , 2018). After Mongolia hosted the Dalai Lama in 2016, it took one month for China to "cease imports of Mongolian commodities and cancelled a visit by Mongolia's Deputy Prime Minister to Beijing […] Given that 75 percent of Mongolia's exports rely on its trade with China […] Mongolia's decision to back down and apologize was a foregone conclusion" (Rein, 2018).

Simultaneously, there are several cases where foreign governments have profited from China's economic support but the subsequent governments turned their back on China: "China's influence efforts collapsed in Malaysia, the Seychelles, and Sri Lanka when democratic elections evicted corrupt elites who had taken China's BRI money and profited from it" (Shambaugh, 2020). As Shambaugh put it, "the use of credit to generate international influence has led to a lower economic rate of return and uncertain diplomatic gains" (Shambaugh, 2020). The Chinese economic statecraft experience in Europe gets a passing grade. Allegedly, Croatia, Hungary and Greece have been willing to do "China's political bidding in return for investment" (Rein, 2018), and "If Italy is Beijing's southern entry point into Europe, Belgium is its northern gateway" (Hamilton & Ohlberg, 2020). The strategy has focused more on carrots than sticks: "China adopts a positive form of economic diplomacy that offers commercial incentives" (Wong R. , 2017). But there have been exceptions, namely the Chinese boycott to Norwegian salmon exports after the 2010 Nobel Peace Prize was awarded to Liu Xiaobo.

We covered the EU-China relationship in Chapter 3, as well as the bilateral relations between China and every single member state. While the relationship with some countries has been deteriorating in the last few years, China is being able to maintain a solid base of supporters within the EU. At the EU supra-national level, "in comparison to other EU institutions or most of the Member States, which are more concerned with the tangible commercial interests in their relations with China, the European Parliament has traditionally taken a more strident approach, focusing on the political and normative issues" (Wong R. , 2017).

There are three important reasons why China can maintain a constructive economic statecraft relationship with several EU countries. First, the issues about which China wants to ensure non-opposition from the EU are very important to China but not very important to the EU: the Dalai Lama, the Maritime disputes, the Hong Kong protests and the domestic HR issues. As such, the inducements that China is willing to offer more than compensate for the incurred costs. Second, the EU is increasingly neglecting more and more peripheral countries (namely in the South and East), whose populations increasingly adhere to more nationalistic political value propositions. With that, more and more countries are compelled to do China's political bidding, in exchange for its inducements. Finally, a geographical reason – China is distant, the Europeans have no security interest in the Pacific, and China is not moving militarily into the Atlantic.

Part 2 – Methodological approach and empirical study

6. Measuring Political Influence Potential (PIP) of COFDI

6.a. Importance of measuring PIP and proposed methodology

As mentioned before, the concerns regarding political influence arising from FDI are a recent phenomenon in the academia and in the Western media. This happens because, for a long time, FDI was essentially originated essentially in the West. A *google scholar* search for "FDI" & "political influence" or "political risk", before 2010, only presents documents about the political risk of investing in less developed countries and immature democracies with weak rule of law. The academic production about FDI political risks appear in the last decade, namely associated with autocracy promotion by "revisionist" regimes (Russia, Iran, Venezuela, and China).

Moreover, for a long time, the *Washington consensus* suggested that economic integration between the Western and non-Western countries would lead to increased economic development and a gradual democratization of the non-western counterpart. The *constructivist* mechanism through which it would happen was explained in Part 1.

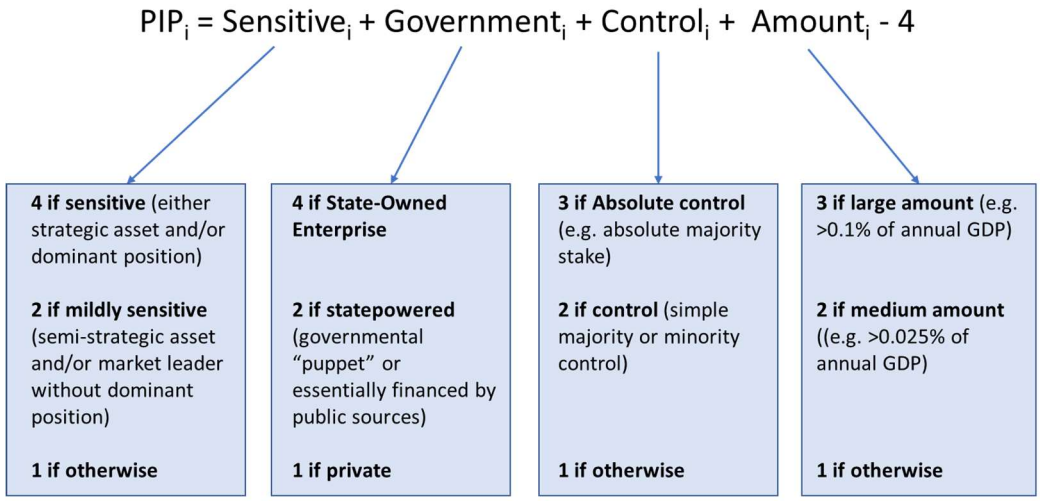
The rise of China called for academic and regulatory attention. Because of the recent importance of the phenomenon, there is no commonly agreed methodology for measuring PIP. The few references which can be used for discussing how to measure PIP come from FDI regulation. Some of the most relevant are presented in Chapter 4. The analysis of the screening mechanisms, which remain vague, allows to surface six main themes: the strategic sensitiveness of the target, the degree of governmental control over the buyer, the control of the buyer over the target, the value ($) size of the transaction, the degree to which the sale process involves active touting from the Government of the selling country, and the existing stock of OFDI from that sender country in the target country (or at least in the segment or the value chain of the

target). The regulation references and the thesis' interviews suggest that the first four themes are more important and less ambiguous to assess.

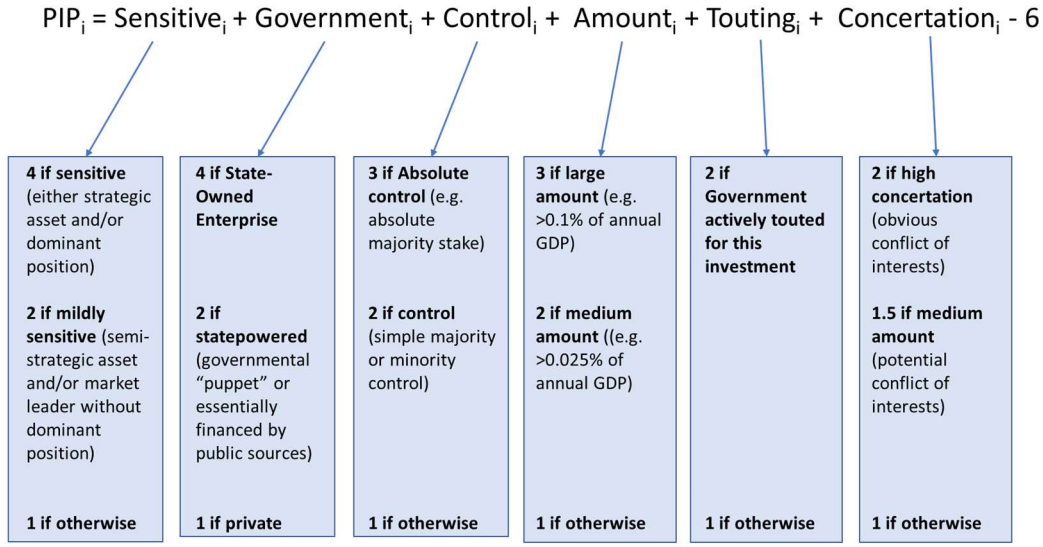
If there was a standard methodology to measure the PIP of an FDI case, that would be an important tool to reduce the existing subjectivity associated with FDI regulation, including COFDI. The new EU screening mechanism provides a framework for doing so in the EU, but does not go as far as proposing an actual methodology which can be uniformly applied.

The proposed algorithm for calculating the PIP is an additive formula and the data needed as input should be surfaced through the usage of the case study method.

The preferred version of the proposed formula is:



An alternative version of the algorithm including the six (not four) themes could be:



The proposed methodology is illustrated *ad nauseum* in Section *7.b.* The proposed formulas are purposefully kept simple – nothing could be simpler than summing up the discrete evaluations of each investment, in each variable. Also, the weighting could not be simpler. It gives a maximum amount of 4 to the top 2 variables and a maximum amount of 3 to the second pair of important variables to acknowledge the prioritization among them. In using the second version of the formula, it is proposed to use a maximum value of 2 for the two additional variables. Since the minimum value is 1 then the ranges are [1-4], [1-3] and [1-2] for each pair of variables. The formulas deduct the number of variables used, so that the minimum result is 0.

If these variables and the case study method is accepted as the method of qualification, then it would be interesting to consider more sophisticated formulas.

This thesis proposes two upgrades but does not apply them yet. A first alternative is to learn from multicriteria decision analysis frameworks, which are common in healthcare. When a healthcare regulator needs to consider multiple decision criteria and worries about unintentionally biasing the results, it can use weighting methods which have the actual data defining the weights. Figure 135 compares several of the available alternatives.

Figure 135. Weighting methods trade-off domains

Method name	Resource requirement	Software requirement	Chance of bias	General complexity
Direct weighting	Low	No	High	Very low
SMART combined with swing weighting	Low	No	Moderate–high	Low
AHP	Moderate	Not necessarily	Moderate	Moderate
MACBETH	Moderate	Yes	Moderate–low	Moderate
DCE	High	Yes	Low	High
PAPRIKA	High	Yes	Low	High
CA	High	Yes	Low	High

AHP: Analytic hierarchy process; CA: Conjoint analysis; DCE: Discrete choice experiments; MACBETH: Measuring attractiveness by a categorical-based evaluation technique; PAPRIKA: Potentially all pairwise rankings of all possible alternatives; SMART: Simple multiattribute rating technique.

Source: (Németh, 2019)

A second alternative would be to reverse the qualification approach and start by defining the PIP level based on perceptions, calculated through surveys or sentiment analysis[11], and then use artificial intelligence to determine the best algorithm to calculate the weighting. In doing so, it could use black-box approaches like *neural networks* or use more transparent methodologies such as *random forest.* Both have pros and cons, which have been extensively discussed by the academia in other fields. The paper *Trees vs Neurons: Comparison between random forest and ANN for high-resolution prediction of building energy consumption* (Ahmad, Monjur, Mourshed, & Rezgui, 2017) is just one among several examples available.

11 "Sentiment Analysis or Opinion Mining is the computational study of people's opinions, attitudes and emotions toward an entity. The entity can represent individuals, events, or topics" (Medhat, Hassan, & Korashy, 2014). One alternative would be to use sentiment analysis of news articles (and social media feeds?) about COFDI and measure the level of *concern* about their PIP through that methodology.

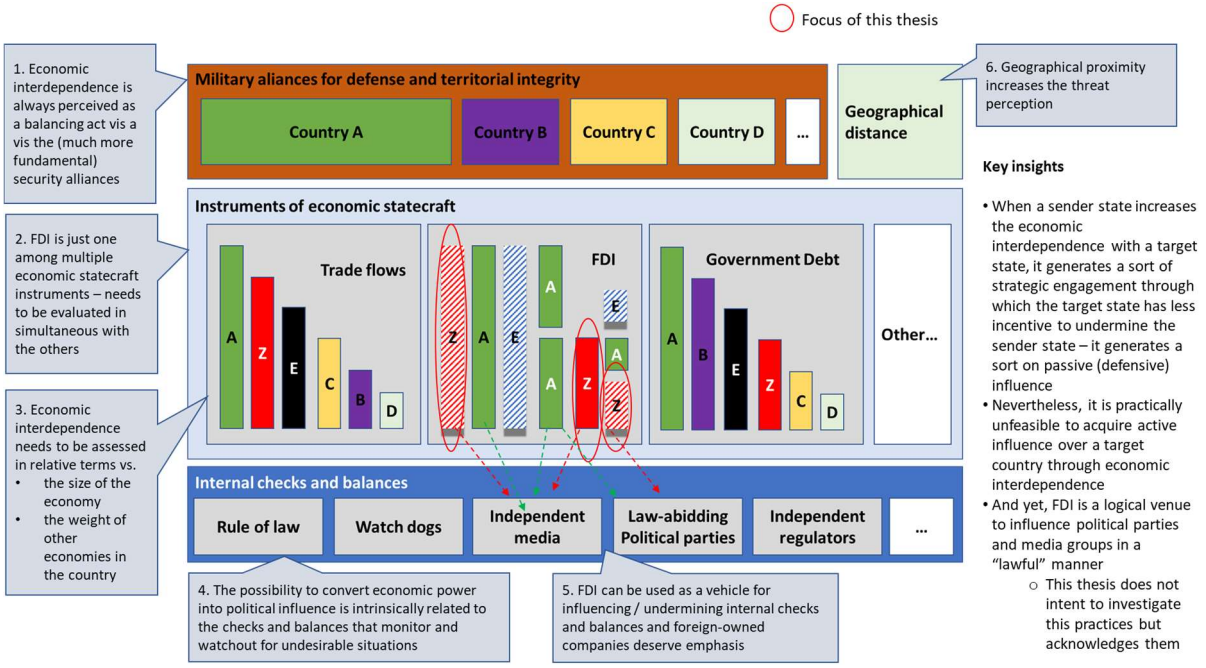
6.b. Reflection on PIP of the stock of FDI in each country

The ultimate objective of evaluating FDI and PIP is to identify situations where one state is potentially influenced by another state. This must be envisioned in a spectrum, not as binary.

By focusing on the individual PIP of each investment, this thesis focuses on advancing the knowledge about evaluating each of the building blocks in just one out of several economic statecraft instruments. This contribution intends to develop knowledge about some pieces of the puzzle but understands that the full puzzle treats a much broader image.

Figure 136 proposes a framework to think about what else needs to be evaluated, and synthesizes key insights about the role of FDI within it.

Figure 136. IFD within the broader picture of PIP



Source: By the author

This framework puts the instruments of economic statecraft in the center but surrounded by the military alliances (above) and internal checks and balances (below). It also introduces geographical distance alongside the military alliances. With this disposition, it intends to highlight that economic interdependence is always counterbalanced by military considerations and is scrutinized by domestic structures. Countries may engage economically with non-allies

but only until it threatens their national security. Moreover, it points out that security threats are more frightening from neighbors than from distant actors.

The internal checks and balances are composed by several institutions, which include the rule of law, watch dogs, independent media, political parties, and independent regulators.

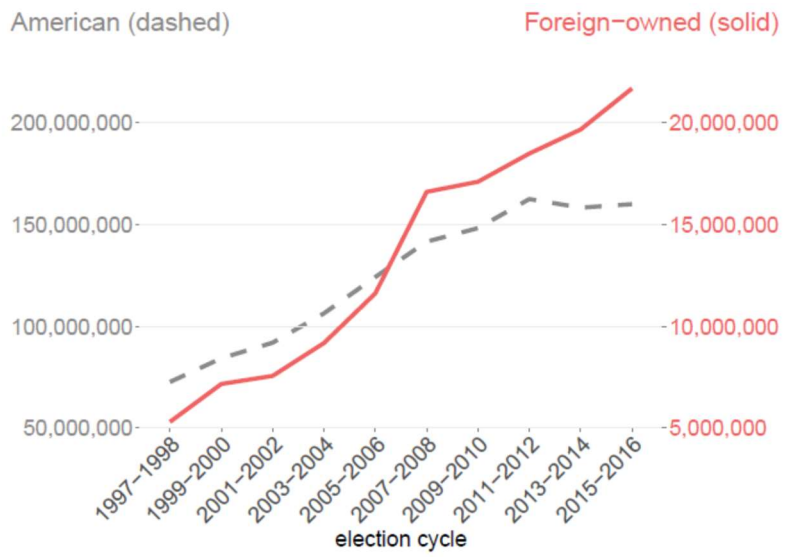
Within the economic statecraft realm, we find several instruments which include trade flows, the holdings of Government debt, and the stock of FDI, among others. This is meant to highlight that FDI is one among several instruments, so its relevance must be analyzed in that context.

Within the FDI space, it is important to distinguish sensitive assets (displayed in striped background) from non-sensitive assets, and also to evaluate the FDI from one sender state in relation to the overall size of the economy and to the FDI from other senders.

Finally, the arrows pointing out from the FDI to the *checks and balances* illustrate that owning companies in a country increases the ability to influence political parties and media outlets through financial contributions. Lobbying is a big word, and without dwelling on it, it is intuitive to understand that it is not illegal for a company to have a large PR budget which is paid directly to media companies as sponsorship and indirectly through contributions to PR intermediaries and lobbying service providers. These amounts can subtly but easily acquire defensive protection and even secure supportive media. Likewise, companies frequently use legal services, consulting services or lobbying budgets to donate resources to party financing.

The mechanisms through which FDI can help with political interventionism were already covered. For example, the US Federal Election Campaign Act was "designed to protect the independent sovereignty of US elections" prohibiting foreign nationals "from contributing, donating, or spending funds in connection with any federal, state, or local elections, either directly or indirectly. And yet […] US subsidiaries of foreign firms are allowed full and equal participation in US election campaigns" (Lee, 2018). The contributions from subsidiaries from foreign firms to US elections grew faster than domestic contributions (Figure 137).

Figure 137. USD amount of campaigns: American vs. foreign-owned firms



Source: (Lee, 2018)

Also, Kim & Milner revealed that, at least in the USA, foreign-owned companies "spend more on lobbying and lobby across a more diverse set of issues than do domestic firms […] when a firm turns multinational its political activity changes: it becomes more active, lobbying more and over more issues" (Kim & Milner, 2020).

The conclusion is that when a sender state increases the economic interdependence with a target state, it generates a sort of strategic engagement through which the target state has less incentive to undermine the sender state – it generates a sort of passive (defensive) influence. Nevertheless, it is practically unfeasible to acquire active influence over a target country through economic interdependence alone. And yet, FDI is a logical venue to influence political parties and media groups in a *lawful* manner. This thesis does not intend to analyze these practices but acknowledges them.

7. Uncovering COFDI in Portugal

7.a. Aggregate stock of COFDI in Portugal

COFDI databases underestimate it for several motives. CGIT database estimates COFDI in Portugal between 2011 and 2019 at USD 9 Bn. MERICS estimates it at EUR 6 Bn (USD ~6.6 Bn) and the *Banco de Portugal* at EUR 2.5 Bn (USD ~2.8 Bn). According to the firm-level analysis of this thesis, the total amount of COFDI in Portugal is about EUR 17.3 Bn if we include EUR 5Bn which were invested in energy projects of Portuguese companies (EDP, EDPR and Galp) abroad, and EUR2.7 Bn in RE in the Portuguese territory (Figure 138).

Figure 138. COFDI in Portugal between 2011 and 2019

Group	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total	
Energy PT	2 690	746	-	94	1 000	-	456	800	-	**5 786**	
Fosun	-	-	-	1 725	26	207	386	140	-	**2 484**	
GoldenVisa	-	-	243	745	348	524	336	288	235	**2 719**	
Haitong	-	-	-	-	479	-	419	-	-	**898**	
Other	-	10	4	105	67	41	90	42	87	**446**	
Total	**2 690**	**756**	**247**	**2 669**	**1 920**	**772**	**1 687**	**1 270**	**322**	**12 332**	Excluding energy abroad
Energy abroad	-	3 922	-	140	314	363	-	218	-	4 957	
Total ++	2 690	4 678	247	2 809	2 234	1 135	1 687	1 488	322	17 289	Including energy abroad

Source: Author estimates based on case studies

For the time being, this thesis assumes that total COFDI should not include the EUR 5 Bn of energy investments abroad with Portuguese companies, in which case the total is EUR 12.3 Bn, or USD 15.3 Bn. If we excluded EUR 2.7 Bn in RE, the total COFDI would be EUR 9.6 Bn between 2011 and 2019. The COFDI distribution in Portugal can be summarized in three points:

- It is composed of five groups of investments: Energy in Portugal (47 percent), RE (22 percent) mostly driven by golden visas; Fosun (multiple) investments (20 percent), Haitong acquisition and further capitalization of BESI (7 percent) and all others (4 percent).

- The years of 2011 and 2014 concentrate each 22 percent of the total investment in the period, driven by the privatizations of EDP and Caixa Seguros. 2015 saw the third largest COFDI flow due to the 100 percent acquisition of Iberwind (renewable energy) by the largest HK investment group CKI, and the acquisition of BESI by Haitong.
- The “others” (4 percent) group includes a broad set of investments across all sectors of the Portuguese economy. This includes the Portuguese operation of Huawei, Tianying investment in Groupama (insurance) and SUMA (waste management), Beijing Waters acquisition of Veolia (water distribution), 30 percent of the fourth largest media group Global Media, two small banks, several greenfield industrial projects, food production projects and nine secondary soccer teams.

7.b. Library of COFDI case studies in Portugal

In explaining the methodology used for developing the investment case studies three main considerations need to be presented.

The *first consideration* is about the rationale for using the case-study method. According to Robert Yin, which is a reference for this thesis,

> "In general, case studies are the preferred strategy when 'how' or 'why' questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context." (Yin, 2008).

With the development of the case studies about COFDI in Portugal, the investigation aims to answer "why" and "how" specific Chinese investors invested in specific Portuguese companies. The case studies are both descriptive and explanatory and the research questions are:

- **Who are the investors and what are the invested companies?** What, where and how were their business activities prior to the transaction? Who are the key decision makers?
- **How was the deal accomplished?** What was the acquisition process? What were the deal terms? What was the business plan? Did the Chinese investors appoint the management team? What was the financial performance? How was the deal financed?
- **Why did the buyer decide to acquire the target?** Were there political or national strategic motivations? Did it result from active touting by the Portuguese Government? Is this ownership relevant enough to be leveraged for political influence in the future? Is there evidence of concertation with other Chinese companies in the market?

The *second consideration* is about the structure used for presenting each investment case study. Following Yin, the case studies are organized in three sections.

- *Environment* - incorporates insights regarding the context prior to the investment, such as history of the companies, business activities, geographical footprint, financial performance, ownership, recent events, and the relationship with other COFDI cases.

- *Strategy* - includes the acquisition process, deal terms, business plan, financing mechanism and motivations of the buyer and the seller.
- *Performance* - assesses the financial performance after the transaction, future prospects, the evolution of the Chinese control, evidence of synergies, relevance in the country, concertation with other Chinese investments, and ability to grow overseas.

The *third consideration* is that two types of insights are generated by the case studies.

The first type is descriptive information regarding each investment case. This information is obtained by attempting to answer the questions presented in the *first consideration* above and structured in the three sections described in the *second consideration*. These answers are extracted from interviews to stakeholders involved in the deals, namely senior managers of the Chinese investor and Portuguese targets. Other market observers are also tapped into.

The second type are informed qualitative evaluations about how each investment case corroborates nine key propositions (or characterizing features) about COFDI in Portugal, base on which it becomes feasible to judge the potential political implications of COFDI in Portugal. The nine key propositions being analyzed are the following:

1. COFDI is concentrated on Strategic Assets, Sensitive Industries or players with dominant position which could potentially be leveraged for political influence by China;
2. COFDI is predominantly executed by companies with very close ties to the Chinese Government, being it SOE or Private Enterprises with significant reliance on Government-backed financing (herein called *state-powered*);
3. COFDI coming from both SOE and private companies require controlling stakes and the ability to steer the companies' decisions;
4. COFDI is concentrated on assets that were actively touted by the Portuguese Government (in privatization processes or not);

5. COFDI investors in Portugal tend to coordinate their business activities among themselves;
6. COFDI is concentrated on mature assets, not so much on greenfield projects or those responsible for significant job creation;
7. Portugal represents an entry door in third countries because COFDI is predominantly executed by companies (not present in and) searching for market access in Europe, Africa and Latam;
8. COFDI is more concentrated on companies from where know-how can be extracted than on companies where the Chinese investor can add value;
9. COFDI in Portugal has had good economic performance so far.

On top of evaluating these propositions, the case studies also gather the available sources about the amounts involved in the deals.

In summary, if the nine propositions were validated, one could argue that COFDI in Portugal was mostly concentrated in controlling stakes, under direct influence from the Chinese state, looking for either scarce know-how or third-market access, in sensitive industries or strategic assets, without adding much value other than immediate financial relief to the target companies or the country, constituting already an active coalition with effective lobbying capabilities, and achieving reasonably good economic performance.

The COFDI case studies are presented in appendix A. Some of the cases are presented jointly because of their interdependence.

7.c. Main insights from the case studies

Figure 139 is a database which characterizes the case studies based on their PIP and the relevant dimensions used in estimating it. Regarding the PIP, the estimate with both formulas is presented (four variables and six variables), and a PIP grouping (distinguishing high, medium and low). Four input variables are included: *sensitive*, *Government*, *control* and *amount*.

Figure 139. COFDI investments database for network analysis

COFDI case	PIP 1	PIP 2	PIP Group	Case size	Sensitive	Government	control	Amount
CSGC-REN	**8**	10	**High**	Large core	Sensitive	SOE	word-to-say	$$$
Fosun-Fidelidade	**8**	10	**High**	Large core	Sensitive	Statepowered	Absolute	$$$
CTG-EDP	**8**	9,5	**High**	Large core	Sensitive	SOE	word-to-say	$$$
CNIC-EDP	**8**	8,5	**High**	Large add-on	Sensitive	SOE	word-to-say	$$$
Fosun-BCP	**7**	8,5	**High**	Large core	Sensitive	Statepowered	Control	$$$
CNBM-Solar	**7**	8	**High**	Large Greenfield	Mildsensitive	SOE	Absolute	$$
BeijingWater	**7**	7	**High**	Large core	Mildsensitive	SOE	Absolute	$$
CTG-EDPR	**6**	7,5	**High**	Large add-on	Mildsensitive	SOE	word-to-say	$$$
Haitong-BESI	**6**	7	**High**	Large core	Mildsensitive	Statepowered	Absolute	$$$
Huawei	**6**	6	**High**	Large Greenfield	Mildsensitive	SOE	Absolute	$
CKI-Iberwind	**6**	6	**Medium**	Large core	Mildsensitive	Private	Absolute	$$$
FosunFID-REN	**5**	7	**Medium**	Large add-on	Sensitive	Statepowered	word-to-say	$$
Bison-BanifBI	**5**	6	**Medium**	Large core	Mildsensitive	Statepowered	Absolute	$$
Fosun-LuzS	**5**	6	**Medium**	Large add-on	irrelevant	Statepowered	Absolute	$$$
Tianying-UNA	**5**	5	**Medium**	Small	Mildsensitive	Statepowered	Absolute	$$
COFCO	**5**	5	**Medium**	Large Greenfield	irrelevant	SOE	Absolute	$
KNJ-GMedia	**4**	4,5	**Medium**	Small	Sensitive	Statepowered	word-to-say	$
GoldenVisa	**4**	4	**Medium**	Small	irrelevant	Private	Absolute	$$$
NF-Marfresco	**4**	4	**Medium**	Small	irrelevant	SOE	Control	$
CSCEC-TD	**4**	4	**Medium**	Small	irrelevant	SOE	Control	$
ZhejiangSteel	**4**	4	**Low**	Small	irrelevant	Private	Control	$
CA-MontePasto	**3**	3	**Low**	Small	irrelevant	Private	Absolute	$
TianyingEGF	**3**	3	**Low**	Small	Mildsensitive	Statepowered	word-to-say	$$
HNA-TAP	**2**	3	**Low**	Large core	Mildsensitive	Statepowered	word-to-say	$
HengTongAC	**2**	3	**Low**	Large core	irrelevant	Private	Absolute	$
9Soccer	**2**	2	**Low**	Small	irrelevant	Private	Absolute	$
Kinlong-CIFIAL	**2**	2	**Low**	Small	irrelevant	Private	Absolute	$
FosunJMendes	**1**	1	**Low**	Small	irrelevant	Statepowered	word-to-say	$
WuhanSteel	**1**	1	**Low**	Small	irrelevant	Private	Control	$

Source: By the author

The table also mentions the type of display used to present each case study. To avoid a tiresome description, only 10 cases have a full description (five-pagers called *large core*), four are small

versions of add-ons to large cases (one-pagers called *large add-on*), three are *large greenfield cases* (two-pagers) and twelve are small versions (one-pagers).

The table permits moving from a qualitative approach to a mixed-methods approach. Mixed methods research is defined "as research in which the investigator collects and analyses data, integrates the findings, and draws inferences using both qualitative and quantitative approaches" (Tashakkori & Creswell, 2007). We mix qualitative analysis based on case study method with network analysis to surface the characterizing patterns of COFDI in Portugal. Network analyses have been around for decades:

> "While anthropologists had long used network concept as partial, allusive descriptions of social structure (Sundt, 1968; Radcliffe-Brown, 1940; Bohannan, 1954), several analysts started developing these concepts more self-consciously and systematically in the 1950s, defining a network as a set of ties linking social system members across social categories and bounded groups." (Wellman, 1983).

Social networks are used in several social sciences fields, from mapping social media interactions among individuals to evaluating the evolution of FDI over time among countries[12]. Social networks are constituted of nodes and edges, where nodes are independent "dots" plotted in a space and edges are the links between each two nodes. Both nodes and edges are characterized by certain densities or sizes, but can be also categorized by how they interact with the network

> "Networks are a way of thinking about social systems that focus our attention on the relationships among the entities that make up the system, which we call actors or nodes. The nodes have characteristics, typically called attributes, that distinguish among them […] relationships between nodes also have characteristics, and in network analysis we think of these as ties or links." (Borgatti, Everett, & Jonhson, 2013).

12 *Global FDI: A network perspective* was pioneer in introducing single-node network methodology to the study of FDI, filling in the old gap of "evaluating the overall network of investment relations, how it has formed, and what sort of role does it take in assimilating country/relations and then producing consequences to country performance" (Luis, Casanueva, & Castro, 2019). Instead of studying FDI based on stock and flows, it studies FDI from a relational point of view.

The typical usage is to have individuals as nodes and their interactions as edges "the nodes in a network can be almost anything […] most often, nodes are individuals" (Borgatti, Everett, & Jonhson, 2013). Networks can be represented as *graphs*, which are "mathematical objects consisting of two sets: a set of vertices and a set of edges connecting the vertices", or as matrices "with the adjacency matrix being by far the most common way to do this". There are multiple methods to visualize *graphs* and multiple software mapping very large and complex networks. We use network analysis as a tool to identify patterns of COFDI in Portugal. Network analysis is increasingly used for identifying clusters:

> "Embedded within a network there are often groups of actors who interact with each other to such an extent that they could be considered to be a separate entity […] We call any such group a 'cohesive subgroup', although a number of other terms are also used, such as 'cluster' and 'community'. In examining network data we would first try to detect the cohesive subgroups and then, by looking at common attributes, see if there was some underlying principle that could explain why they identify with each other." (Borgatti, Everett, & Jonhson, 2013).

The author learned to use network analysis at *The Europaeum Program*[13], where it was used to identify clusters among the 200+ fuel poverty energy initiatives in the EU.

Theoretically, this approach departs from a typical one-mode network and uses a two-mode or bipartite network. In (Borgatti, Everett, & Jonhson, 2013), the theoretical guide for this thesis, it is clarified that "network data consisting of ties between and not within two distinct groups is known as two-mode data". Other authors have also applied this methodology to political science, for example in studying the influence from foreign entities on Czech assemblymen.

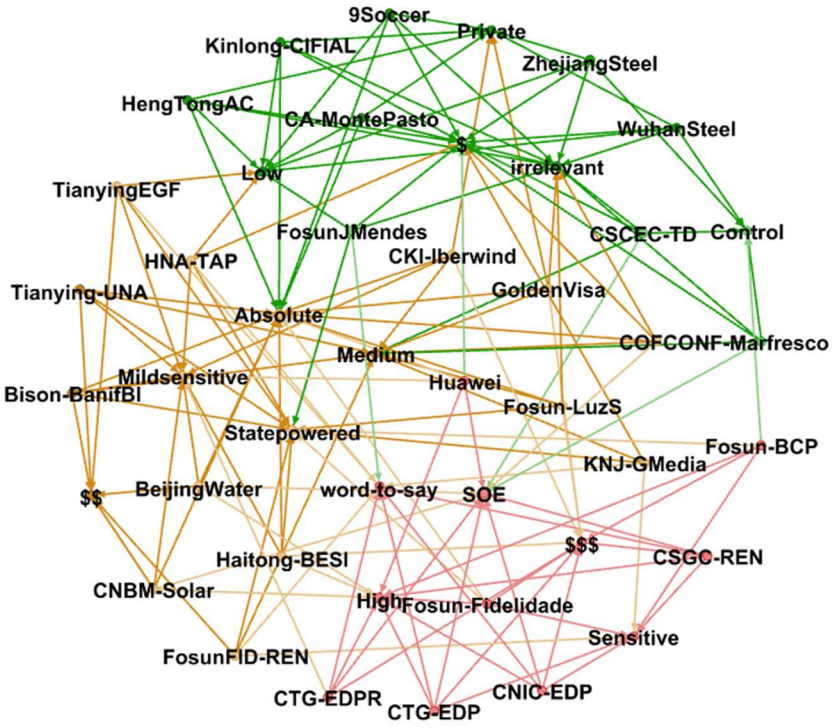
> "In one-mode networks, there is just one type of node (e.g., only politicians or only groups), while in two-mode networks, there are two distinct sets of nodes analysed simultaneously (in our case, deputies and interparliamentary groups)". (Mochtak & Diviak, 2019).

[13] *The Europaeum*, created by the Oxford University (1992), associates 17 European universities (https://europaeum.org/). The *scholars program* gathers 30 PhDs from 20+ countries and 15+ fields to collaborate on EU policy recommendations for 2 years

This thesis uses network analysis to identify homogenous clusters of COFDI and find what drives PIP. We are not interested in the relationship among the investees and the investing companies. The nodes are the investment cases (e.g., CTG investment in EDP), the discrete qualification possibilities that each investment can take for each variable and the PIP level (high vs. medium vs. low). The edges are the relationship between each investment and its attributes. As an illustration, CTG investment in EDP generates four edges (see first line of Figure 169) which are: *CTG-EDP & Sensitive*, *CTG-EDP & SOE*, *CTG-EDP & Word-to-say*, *CTG-EDP & $$$* and *CTG-EDP & High*). We input the data to Gephi software, which "is an open-source software for graph and network analysis. It uses a 3D render engine to display large networks in real-time and to speed up the exploration" (Bastian, Heymann, & Jacomy, 2009).

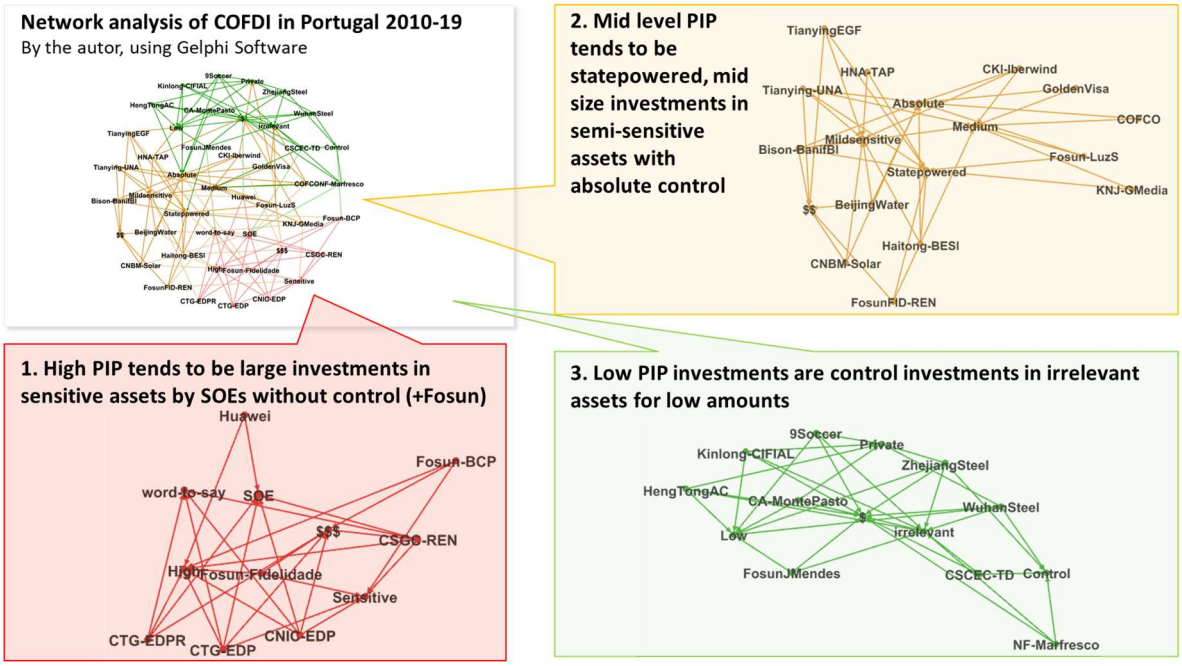
The modularity of the network is calculated using resolution 1 and randomize option *on*. It generated three communities with 0.355 modularity coefficient (which is not too low). Figure 140 displays the results using Fruchterman Reingold layout, and Figure 141 separates the three clusters and summarizes the key insights of the analysis.

Figure 140. Fruchterman Reingold layout of COFDI in Portugal



Source: By the author, using Gephi software

Figure 141. Big picture insights about COFDI in Portugal



Source: By the author, using Gephi software

The red cluster includes the feature *high* and allows us to say that high PIP cases tend to be large investments in sensitive assets by SOE but without control. Importantly enough, Fosun's investments in BCP and Fidelidade, despite not being SOE (they are *state-powered*) fall in this cluster. Other cases fitting in this cluster are CSGC investment in REN, CTG investments in EDP and EDPR, CNIC investment in EDP and Huawei's organic growth.

The green cluster, which includes the *low* feature, shows that low PIP investments are generally small investments in non-sensitive assets or private investments. Curiously enough, it includes the control feature (not absolute control). In the middle, the orange group includes medium PIP cases, associated with midsize amounts, in mild sensitive assets and absolute control.

The main takeaway relates to the behavior of the *control* variable – very large investments in sensitive assets are either made without control or by state-powered firms which conceal their publicness. Because the level of control and the level of relationship with the state is not clear cut, regulators should pay attention to these investments and investigate these attributes.

The remaining of this section discusses the nine key propositions analyzed individually for each case study. The first three are the most important and their assessment is more detailed.

1. *COFDI is predominantly executed by companies with very close ties to the Chinese Government, being it SOE or Private Enterprises with significant reliance on Government backed financing (herein called state-powered).*

There is no clear cut between public and private in China. Instead, this is better understood as *shades of grey* and subjectivity is unavoidable. This thesis categorizes each case with one of three levels: **SOE**, if the company is clearly state-owned, **state-powered**, if it is privately owned but has access to extensive public financing with very limited restrictions; and **private**, if there is no evidence to argue that the firm is controlled by the CCP. According to that, COFDI in Portugal is 40 percent SOE, 29 percent state-powered and 31 percent private. The SOE include 84 percent of the FDI in energy (all except for CKI's investment in Iberwind), the water investment, and a few small investments. Private investments include 97 percent of the RE, EUR 1 Bn of CKI investment and other small investments. The state-powered investments are those from Fosun, Haitong, Tianying and other small investments.

If we exclude the RE investments, COFDI is essentially state-driven. Therefore, judging if the proposition is true is intrinsically linked to our judgement if Fosun and Haitong are economic agents controlled by the CCP. As mentioned previously, the evidence available suggests that Fosun is part of a handful of companies (together with Anbang, HNA and others) to whom the Chinese Government gave *carte blanche* (and financing) to invest abroad in the early 2010s but, in 2016-17, they were considered too loose and were halted (e.g., taking over their governance and significantly reducing their access to funding). Haitong is HK-based but partially state-owned. The final verdict is that **it is fair to say that COFDI in Portugal was almost exclusively driven and endorsed by the Chinese Government**.

2. *COFDI in Portugal is concentrated on Strategic Assets and Sensitive Industries.*

The definition of strategic assets or sensitive industries is not consensual, but incorporating the views of several FDI regulators, it is reasonable to break it down in three levels (Figure 142).

Figure 142. Breakdown of COFDI according to sensitiveness

COFDI case	PIP 1	PIP 2	EUR	Sensitive
ZhejiangSteel	4	4	13	irrelevant
WuhanSteel	1	1	12	irrelevant
NF-Marfresco	4	4	4	irrelevant
Kinlong-CIFIAL	2	2	2	irrelevant
HengTongAC	2	3	8	irrelevant
GoldenVisa	4	4	2 719	irrelevant
Fosun-LuzS	5	6	460	irrelevant
FosunJMendes	1	1	42	irrelevant
CSCEC-TD	4	4	31	irrelevant
COFCO	5	5	10	irrelevant
CA-MontePasto	3	3	38	irrelevant
9Soccer	2	2	4	irrelevant
			3 342	27%

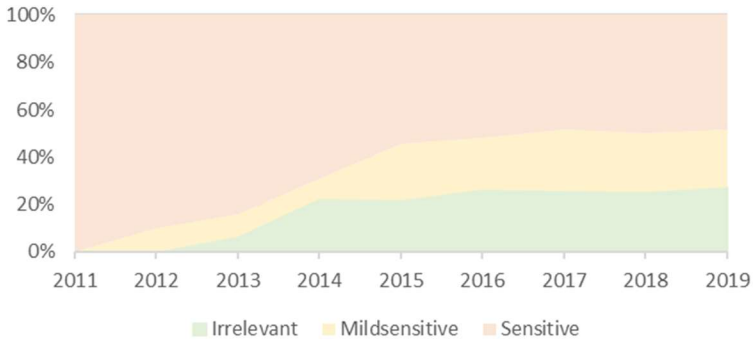
COFDI case	PIP 1	PIP 2	EUR	Sensitive
Tianying-UNA	5	5	70	Mildsensitive
TianyingEGF	3	3	58	Mildsensitive
Huawei	6	6	10	Mildsensitive
HNA-TAP	2	3	30	Mildsensitive
Haitong-BESI	6	7	898	Mildsensitive
CTG-EDPR	6	7,5	701	Mildsensitive
CNBM-Solar	7	8	140	Mildsensitive
CKI-Iberwind	6	6	1 000	Mildsensitive
Bison-BanifBI	5	6	47	Mildsensitive
BeijingWater	7	7	95	Mildsensitive
			3 048	25%

COFDI case	PIP 1	PIP 2	EUR	Sensitive
KNJ-GMedia	4	4,5	15	Sensitive
FosunFID-REN	5	7	84	Sensitive
Fosun-Fidelidade	8	10	1 209	Sensitive
Fosun-BCP	7	8,5	689	Sensitive
CTG-EDP	8	9,5	2 898	Sensitive
CSGC-REN	8	10	387	Sensitive
CNIC-EDP	8	8,5	660	Sensitive
			5 942	48%

Source: By the author

Sensitive assets (48 percent) include energy (EDP, REN) and Fosun investments (Fidelidade, BCP, REN), but also KNJ investment in Global Media. Some interviewees downplay the relevance of this investment for "not being official" but acquiring 30 percent of the fourth media group with 15 Mn burnt in 4 years cannot be overlooked. **Mild sensitive** assets (25 percent) include other investments in utilities and financial services (and the airline TAP) with less political relevance. The **irrelevant** assets (27 percent) include most RE, but also a broad set of sectors (2019 examples include COFCO's new operational center and CESL Asia's acquisition of Monte Pasto), indicating that the Chinese footprint is spreading, decreasing the bias towards sensitive assets (Figure 143).

Figure 143. Evolution of sensitiveness of COFDI cases in PT



Source: By the author

The final verdict is that **COFDI in Portugal clearly started with sensitive assets but those were gradually followed by non-sensitive assets across several sectors.**

3. *COFDI in Portugal coming from both SOE and private companies require controlling stakes and the ability to steer the companies' decisions.*

The control that the Chinese investor holds over the management and the strategy is central to PIP. This dimension is broken down to three levels. First, **absolute control** (54 percent) requires qualified majority and the right to appoint the management and control the operation. It does not mean that the shareholder can do whatever it wants because many sectors are regulated (e.g., banking). This high concentration is not correlated with PIP – except for the Fosun-Fidelidade case, absolute control is a feature of lower PIP investments (Figure 144).

Figure 144. List of COFDI cases with absolute control

COFDI case	PIP 1	PIP 2	EUR	control
Kinlong-CIFIAL	2	2	2	Absolute
HengTongAC	2	3	8	Absolute
GoldenVisa	4	4	2 719	Absolute
Fosun-LuzS	5	6	460	Absolute
COFCO	5	5	10	Absolute
CA-MontePasto	3	3	38	Absolute
9Soccer	2	2	4	Absolute
Tianying-UNA	5	5	70	Absolute
Huawei	6	6	10	Absolute
Haitong-BESI	6	7	898	Absolute
CNBM-Solar	7	8	140	Absolute
CKI-Iberwind	6	6	1 000	Absolute
Bison-BanifBI	5	6	47	Absolute
BeijingWater	7	7	95	Absolute
Fosun-Fidelidade	8	10	1 209	Absolute

Source: By the author

Second, **Control** (6 percent) means 50 percent ownership or being the most influential shareholder without majority. This is the case of Fosun in BCP (largest shareholder with 29 percent), and three small investments (Marfresco and two industrial greenfields). Finally, "**A word to say**" (40 percent) includes other minority stakes, even if they allow for some representation in the Board, some influence over the management or some strategic saying. These include all other investments, including the sensitive investments in energy assets. When an investor is seeking important know-how, being it regulatory, technological, or about market

access, this ownership may be sufficient to obtain it. The final verdict is that **Chinese investors do not always require controlling stakes.**

These first three dimensions and the deal size are the decisive factors of the PIP of each case. As it turns out, only 26 percent of COFDI is simultaneously a non-private controlling position, in a semi-sensitive or sensitive asset (Figure 145).

Figure 145. Evaluation of COFDI according to top PIP criteria

	Private		Public (SOE or statepowered)			
Sensitiveness	Private absolute	Private control	Public absolute	Public control	Public word-to-say	Total
irrelevant	22%	0%	4%	0%	0%	27%
Mildsensitive	8%	0%	10%	0%	6%	25%
Sensitive	0%	0%	10%	6%	33%	48%
Total Geral	31%	0%	24%	6%	40%	100%

Real estate and Agro

Fosun, Haitong, Water

EDP/EDPR/REN

Source: By the author

Among these, Fosun's are the most sensitive, whereas Haitong is the worst-performing COFDI in Portugal. It is already clear that COFDI in Portugal is not solely a story of SOE control investments in sensitive assets. There are two other groups: 33 percent that are SOE investments in sensitive assets without control and 30 percent that are private investments in non-sensitive assets. Since the last group is mostly composed of RE investments closely linked to the golden visas program, we are particularly interested in understanding the first 33 percent.

4. *COFDI is concentrated on mature assets, not so much on greenfield projects or those responsible for significant job creation.*

In this dimension we breakdown the investments in three groups. The **pure financial investments** (15 percent) include the CKI-Iberwind, Beijing waters, and Fosun investments in BCP, and in REN (via Fidelidade). The **greenfield projects** (2 percent) include six projects (CNBM's solar park being the largest). The remaining 83 percent are investments **where the injected capital enabled growth (**83 percent). The conclusion is that, even if Portugal should privilege opportunities for FDI in greenfield projects, it is not possible to argue that COFDI in

Portugal was all about mature assets. Much of the capital invested enabled the targets to push their businesses forward.

5. *COFDI is concentrated on assets that were actively touted by the Portuguese Government (in privatization processes or not).*

There is some rationale to argue that if an investment results from active promotion and endorsement by the Portuguese State, this may increase the goodwill generated to the Chinese buyer. The cases which included active state involvement in the sale, either public or private, concentrate 56 percent of the total COFDI and include essentially the energy privatizations, the Fosun investment in Fidelidade and the Haitong case.

6. *Chinese companies present in the Portuguese market tend to coordinate their business activities among themselves.*

This dimension analyzes which Chinese investors coordinate among themselves. High coordination seems to be the case in only 8 percent of the cases – some investments from Fosun, some investments in REN, and the cable provider Hengtong (former Alcobre). Simultaneously, all other energy and Fosun investments show some degree of concertation (52 percent). The remaining 40 percent do not deserve special consideration.

7. *Portugal works as an entry door for Chinese companies in third countries because COFDI in Portugal is predominantly executed by companies (not present in and) searching for market access in Europe, Africa and Latam.*

Empirically, many stakeholders suspect that access to the EU and the CPLP is an important motivation for COFDI, and the analysis confirms this perception – 36 percent of COFDI seems to have as primary motivation the access to the EU and Latin America, and 42 percent have this motivation as secondary but important. Market access is only irrelevant to 22 percent of COFDI. If we zoom in on the investments which are non-private, in sensitive assets and without control (EUR ~4 Bn) we find that 88 percent were primarily motivated by market access and access to

know-how. The final verdict is that market access is not a primary motivation to the majority of COFDI, but it is a primary motivation for state acquisitions in sensitive assets without control.

8. *COFDI is more concentrated on companies from where know-how can be extracted than on companies where the Chinese investor can add value.*

Acquiring distinctive know-how was the primary motivation in 41 percent of the cases and an important driver in 25 percent of them. It was not a relevant motivation in 33 percent of the cases. If we zoom in again on the EUR ~4 Bn investments which are non-private, in sensitive assets and without control, we find that 88 percent have access to know-how as an important (but not primary) driver. The final verdict about the eighth proposition is that access to know-how is not a primary motivation to the majority of the COFDI cases, but it is an important motivation for SOE willing to invest in sensitive assets without control.

9. *Chinese investments in Portugal have had reasonably good economic performance so far.*

Most of the COFDI (91 percent) has performed reasonably well so far, and six cases (1 percent) are still "too early to say". At the same time seven cases (8 percent) can be considered to have had poor performance: Haitong, Bison-BanifBI, KNJ-Global Media, HNA-TAP, Tianying-UNA and two greenfields.

Summing up, the analysis of the nine key propositions adds value to the global analysis by:

- Confirming that COFDI is not solely a story of state-owned, fully-controlled stakes in sensitive assets. It identifies two other groups: 33 percent of SOE investments in sensitive assets without control and 31 percent of private investments in non-sensitive assets.

- Showing that access to know-how and new markets is the main rationale behind Chinese SOE willing to invest without control, but refuting that such factors (access to know-how and new markets) are a main driver to the majority of the COFDI stock.
- Finding out that the Portuguese Government only played a prominent (touting) role in 56 percent of the COFDI volume.
- Rejecting that COFDI in Portugal has only been about buying and holding mature assets, because a lot of the capital invested allowed the targets to push their businesses forward.
- Validating that COFDI has performed reasonably well (91 percent did).

7.d. Perceptions of key stakeholders about PIP of COFDI in Portugal

7.d.i Selection of the universe of interviewees

The objective of this section is to assess how the key stakeholders in Portugal perceive COFDI. It is based on 42 contributions which are primary proprietary data of this thesis. Among them, 40 were provided in the format of in-person interviews nominally identified. There are two exceptions. The first is Minister Santos Silva, who, due to the sensitiveness of his role, chose to contribute by pointing out to a published speech. The second is a former executive of Parpública (the public holding). He remains anonymous and is referred to as "Parpública".

The interviews took place in August-December 2019. Appendix B contains 42 one-pagers synthesizing the takeaways from each contribution.

The respondents are organized in five groups according to their roles: nine government officials during the troika period; seven other right-wing officials; six Socialist (post-troika) officials; five Portuguese businesspeople not related to COFDI; six representatives of Chinese interests in Portugal; and nine opinion-makers from journalism, regulation or the academia.

No foreigners were included[14], for two main reasons, the first one practical. In the initial list of target interviewees, there were six groups of foreigners: 1) Chinese diplomats with EU experience; 2) Representatives of the EU/US foreign policy; 3) Senior officials of Chinese Investors; 4) Senior officials in large global institutions overseeing China; 5) Senior officials in foreign FDI regulators; 6) Chinese Journalists. Despite several attempts through different channels, the Chinese representatives, the American representatives, and the EU representatives refused to be interviewed. Regarding the Chinese investors, the regulators and the officials in

[14] Dr. Lin Man, who is in the list, was born in China but moved to Portugal at an early age, so in her own words she is "more Portuguese than Chinese". She attended K-12 school and University in Portugal and worked in Portugal ever since. Until 2018 she was the only China born lawyer in Portugal.

global institutions, many shared their opinions, but few were willing to make their testimonials public. The second reason is related to statistical significance. Once this "limitation" was evident, it was preferred to focus the analysis exclusively on the Portuguese stakeholders, who were available to contribute at the highest levels. With a set of 42 Portuguese respondents the sample is statistically relevant, and the conclusions have generalization potential. This was not the case with the few foreigners available.

The nine officials from the Troika Government are former PM Passos Coelho, the former Vice-PM Paulo Portas, former Minister Miguel Relvas, former Minister Maria Luís Albuquerque and her chief of staff Dr. Filipa Alarcão, former Minister Pires de Lima, former Secretary of State Sérgio Monteiro, former president of AICEP Miguel Frasquilho and the former executive of Parpública.

The six socialist officials include PM António Costa, the MFA Santos Silva, the former Minister of Economy Caldeira Cabral, the Secretary of State Brilhante Dias and two individuals requiring further explanation: the first is Dr. Filipe Soares, who is not from the Socialist Party and is the foreign affairs representative of *Bloco de Esquerda* Party. He is included in this group to avoid a "group of one". The second is Dr. Lacerda Machado, who could be included in several groups because he was a member of a Socialist Government, a representative of Chinese interests (through his role in Geocapital and Forum Macau), and a prominent businessman. But he is also an official advisor to the PM in matters of high complexity and a member of his inner circle, so he was allocated to this group.

The seven right-wing officials not from the Troika period include President Rebelo de Sousa, former President of the EC Durão Barroso, former Minister José Luís Arnaut, former Secretary of State Mário David, Ambassador in China Augusto Duarte and the President of AICEP Castro Henriques. It also includes former President and former PM Cavaco Silva. Because his Presidency is generally considered as a supervising power over the right-wing Government of

the Troika period, it was preferable to allocate him to this group. President Cavaco Silva preferred to be left out of a direct discussion about motivations and political implications, so his contribution is only partially transcribed.

The five Portuguese businessmen not related to COFDI are Dr. Ricardo Salgado, Dr. Fernando Ulrich, Dr. Teixeira Coelho, Dr. Luís Cervantes, and Dr. Nelson Machado. This is a smaller group because these individuals' personal experience is distant from COFDI. Instead of having one contributor from several business sectors it was preferred to have five individuals all seasoned in insurance and banking.

The six representatives of Chinese interests in Portugal include Dr. Magalhães Correia, Dr. Carlos Monjardino, Dr. Sáragga Leal, Dr. Lin Man, Dr. Martins Alves, and Dr. Bernardo Mendia.

The other nine are opinion-makers and include Dr. José Miguel Júdice, Dr. Marques Mendes, Professor Abel Mateus, Professor Fernanda Ilhéu, Dr. Nicolau Santos, Dr. Nuno Rogeiro, Mr. António Costa (hereafter called "António Costa ECO"), Dr. Sousa Tavares and Dr. Carlos Magno.

Five interviews were received with the agreement to not being included in the analysis (their input was, nevertheless, very useful): Professor Adriano Moreira, former Minister Jaime Gama, Dr. Subir Lall, former Minister Luis Amado and General Vasco Rocha Vieira.

7.d.ii Methodology of the interview process

The interviews were conducted in-person and the interviewees received upfront a list of questions which was frequently fine-tuned before or during the interview. The interviews lasted on average 45 minutes and were explicitly recorded, except for President Rebelo de Sousa's. In his case, the interview notes were written based on a 10-minutes audio by the author 5 minutes after the end of the interview. An illustration of the interview guide is presented in Appendix B.

7.d.iii Interviews data treatment

The interviews' input is processed in 6-steps. First, all interviews were transcribed. Second, we use the framework analysis *structured* coding methodology to code the data. This is a matrix based analytic method which "facilitates rigorous and transparent data management such that all the stages involved in the *analytical hierarchy* can be systematically conducted" (Ritchie & Lewis, 2003). It was prepared a matrix where the lines were 13 themes phrased as questions, and the columns were the 42 respondents. All the quotes of each interviewee related to each question were posted in the corresponding cell. The 13 themes are the following:

1) How important is China for Portugal and the EU?
2) How important is Portugal for China?
3) Are you in favor of COFDI in Portugal? Why?
4) Is COFDI better or worse than other FDI in Portugal?
5) What are the motivations behind COFDI in Portugal?
6) Does or will China try to use its economic power in Portugal for political leverage?
7) How does COFDI and China fit into the Portugal-USA relationship?
8) Should Portugal or the EU adjust its FDI regulation?
9) Did Portugal privatize too much during the Troika period?
10) Would you oppose Chinese ownership of a terminal in Sines?
11) Would you oppose Chinese ownership of the Lages base?
12) Can you please share any insights related to any individual COFDI case?
13) Is there any other insight worth noting?

Third, all these quotes were translated to English. Fourth, by getting familiar with the data, it was concluded that the themes could be aggregated into five key questions with discrete qualifications of the replies:

a. Are you supportive of COFDI? *Fan* vs. *Neutral* vs. *No fan;*

b. What drives COFDI in Portugal? *Economic* motivations (if only driven by return on investment); vs. *strategic* motivations (if, independently from the direct economic returns the motivations were related to access to new markets beyond Portugal or access to know-how); vs. *geopolitical* motivations (if, independently from economic and strategic motivations, COFDI was executed in pursuit of political influence or geopolitical considerations);
c. What type of political influence can China achieve through COFDI in Portugal? *None* vs. *Only goodwill* vs. *More than goodwill* (e.g., active support from strong interest groups, coercion or subversion);
d. Did Portugal privatize too much during the Troika period? *Too much* vs. *Not too much* vs. *Too much but that was inevitable;*
e. Is Portugal relevant for China? *Portugal is relevant* vs. *Portugal has marginal relevance*.

Fifth, a database was created with the discrete qualifications plus a variable which identifies the interviewee with his group. This created a sixth variable: What role do you play in the COFDI phenomenon? *Left public official* vs. *Troika Government official* vs. *Right-wing official* vs. *Businessperson* vs. *Representative of Chinese interests* vs. *Media/regulator/academic*

The last step is the application of social network analysis to the database (presented in the next subsection). Before reviewing the conclusions, the reader is encouraged to read the 42 one-pagers synthesizing interviewee's contribution (Appendix B).

7.d.iv. Overall picture of the perceptions about COFDI

Using the same social network analysis methodology presented in Subsection 7.c it was possible to draw important conclusions about the perceptions of the key stakeholders about COFDI in Portugal. The discrete qualifications inferred for the 42 respondents about the six dimensions analyzed are presented in Figure 146.

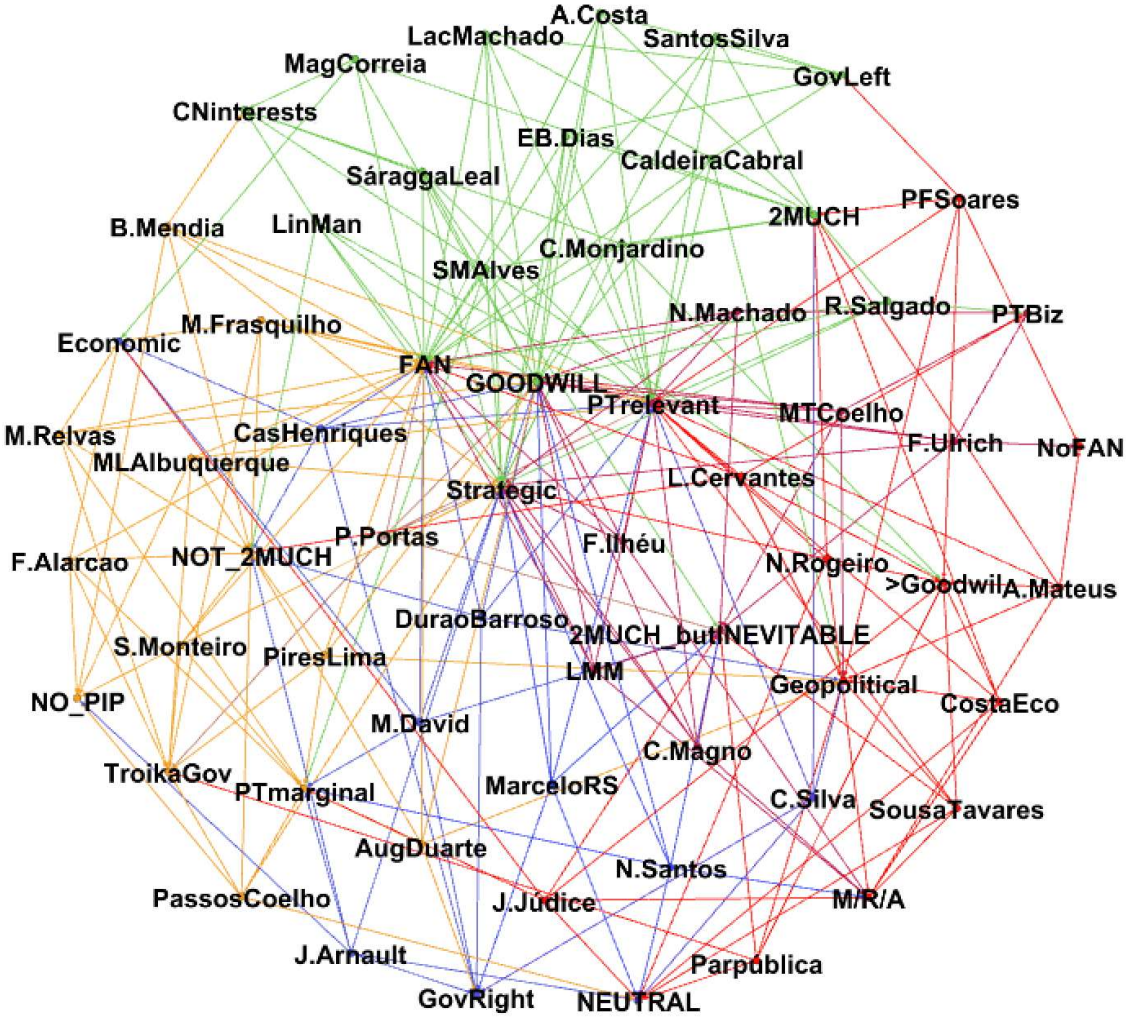
Figure 146. COFDI perceptions database for network analysis

Who	Role	Support	Motivation	PIP	Privatization	PT Relevance	Cluster
A.Costa	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
C.Monjardino	CNinterests	FAN	Strategic	>Goodwil	2MUCH	PTrelevant	Statists
CaldeiraCabral	GovLeft	FAN	Geopolitical	GOODWILL	2MUCH	PTrelevant	Statists
EB.Dias	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
LacMachado	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
LinMan	CNinterests	FAN	Strategic	GOODWILL	NOT_2MUCH	PTrelevant	Statists
MagCorreia	CNinterests	FAN	Economic	GOODWILL	2MUCH	NA	Statists
R.Salgado	PTBiz	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
SantosSilva	GovLeft	FAN	NA	GOODWILL	2MUCH	PTrelevant	Statists
SáraggaLeal	CNinterests	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Statists
SMAlves	CNinterests	FAN	Strategic	>Goodwil	2MUCH	PTmarginal	Statists
A.Mateus	M/R/A	NoFAN	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
C.Magno	M/R/A	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
CostaEco	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
F.Ilhéu	M/R/A	FAN	Strategic	GOODWILL	NA	PTrelevant	Skeptics
F.Ulrich	PTBiz	NoFAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
J.Júdice	M/R/A	NEUTRAL	Economic	>Goodwil	2MUCH_butINEVITABLE	PTmarginal	Skeptics
L.Cervantes	PTBiz	FAN	Geopolitical	>Goodwil	NOT_2MUCH	PTrelevant	Skeptics
LMM	M/R/A	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
MTCoelho	PTBiz	FAN	Geopolitical	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
N.Machado	PTBiz	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
N.Rogeiro	M/R/A	NEUTRAL	Strategic	>Goodwil	2MUCH	PTrelevant	Skeptics
Parpública	TroikaGov	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	NA	Skeptics
PFSoares	GovLeft	NoFAN	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
SousaTavares	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	PTrelevant	Skeptics
C.Silva	GovRight	NEUTRAL	Geopolitical	NA	2MUCH	PTrelevant	Moderates
CasHenriques	GovRight	FAN	Economic	GOODWILL	NOT_2MUCH	PTrelevant	Moderates
DuraoBarroso	GovRight	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTrelevant	Moderates
J.Arnault	GovRight	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Moderates
M.David	GovRight	FAN	Economic	GOODWILL	2MUCH_butINEVITABLE	PTmarginal	Moderates
MarceloRS	GovRight	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Moderates
N.Santos	M/R/A	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTmarginal	Moderates
AugDuarte	GovRight	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
B.Mendia	CNinterests	FAN	Strategic	NO_PIP	NOT_2MUCH	PTrelevant	Liberals
F.Alarcao	TroikaGov	FAN	Economic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals
M.Frasquilho	TroikaGov	FAN	Economic	GOODWILL	NOT_2MUCH	PTrelevant	Liberals
M.Relvas	TroikaGov	FAN	Economic	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
MLAlbuquerque	TroikaGov	FAN	Strategic	NO_PIP	NOT_2MUCH	PTrelevant	Liberals
P.Portas	TroikaGov	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Liberals
PassosCoelho	TroikaGov	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals
PiresLima	TroikaGov	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
S.Monteiro	TroikaGov	FAN	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals

Source: By the author, extracted from the interviews

The hardest dimension to qualify is the perception about the motivations because it is more subjective (nevertheless, only MFA Santos Silva was left blank). Using Gephi software, it is calculated the modularity of the network using resolution 1 and randomize option *on*. It generated four communities with 0.275 modularity coefficient (see Figure 147).

Figure 147. Fruchterman Reingold layout of COFDI perceptions

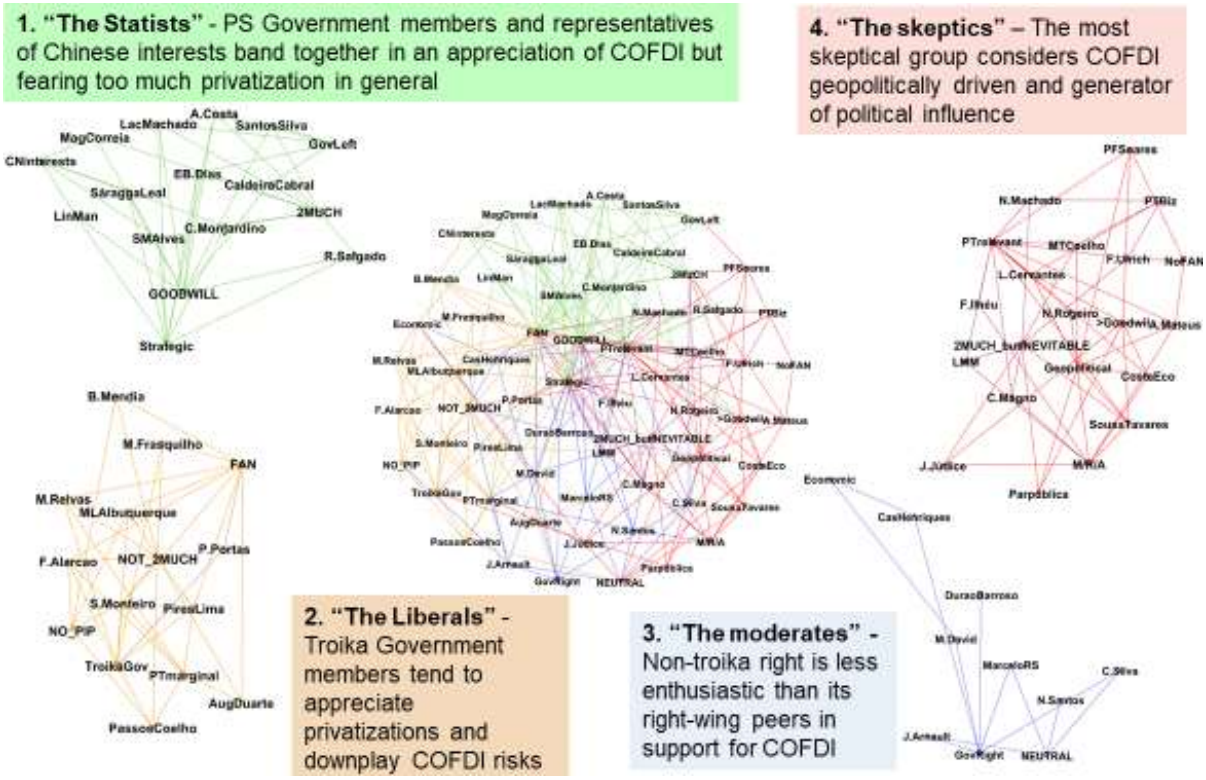


Source: By the author, using Gephi software

From the visualization of the resulting graph, it strikes that the red, the orange and the green clusters are remarkably homogenous. Conversely, the blue color is more blurred with the orange and red colors on each side, so the blue cluster is a sort of median view among those.

There are four clearly identified clusters of respondents (Figure 148).

Figure 148. Big picture insights about COFDI perceptions in Portugal



Source: By the author, using Gephi software

The green clustered – "The Statists" – includes the qualifications *Strategic, GovLeft, Goodwill, CNinterest* and *2MUCH* (Figure 149). Therefore, it is composed of mostly socialist individuals and representatives of Chinese interests in Portugal who appreciate COFDI but, because they do not appreciate the privatization of strategic assets, they would rather not have FDI in those fields. They believe that COFDI has strategic motivations (not geopolitical), and its PIP is essentially about goodwill.

Figure 149. Individuals from cluster 1

Who	Role	Support	Motivation	PIP	Privatization	PT Relevance	Cluster
A.Costa	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
C.Monjardino	CNinterests	FAN	Strategic	>Goodwil	2MUCH	PTrelevant	Statists
CaldeiraCabral	GovLeft	FAN	Geopolitical	GOODWILL	2MUCH	PTrelevant	Statists
EB.Dias	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
LacMachado	GovLeft	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
LinMan	CNinterests	FAN	Strategic	GOODWILL	NOT_2MUCH	PTrelevant	Statists
MagCorreia	CNinterests	FAN	Economic	GOODWILL	2MUCH	NA	Statists
R.Salgado	PTBiz	FAN	Strategic	GOODWILL	2MUCH	PTrelevant	Statists
SantosSilva	GovLeft	FAN	NA	GOODWILL	2MUCH	PTrelevant	Statists
SáraggaLeal	CNinterests	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Statists
SMAlves	CNinterests	FAN	Strategic	>Goodwil	2MUCH	PTmarginal	Statists

Source: By the author

It is interesting that the banker Dr. Ricardo Salgado broadly aligns with this cluster's view.

The orange cluster – "The Liberals" – is composed by the qualifications *TroikaGov, PTmarginal, NOT_2MUCH, NO_PIP* and *FAN* (Figure 150). It is mostly composed by elements of the right-wing Government (Troika period), who appreciate the privatizations as central to COFDI, and do not fear COFDI. They do not believe that too much was privatized, nor that COFDI is a source of political influence, and they see Portugal as irrelevant to China.

Figure 150. Individuals from cluster 2

Who	Role	Support	Motivation	PIP	Privatization	PT Relevance	Cluster
AugDuarte	GovRight	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
B.Mendia	CNinterests	FAN	Strategic	NO_PIP	NOT_2MUCH	PTrelevant	Liberals
F.Alarcao	TroikaGov	FAN	Economic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals
M.Frasquilho	TroikaGov	FAN	Economic	GOODWILL	NOT_2MUCH	PTrelevant	Liberals
M.Relvas	TroikaGov	FAN	Economic	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
MLAlbuquerque	TroikaGov	FAN	Strategic	NO_PIP	NOT_2MUCH	PTrelevant	Liberals
P.Portas	TroikaGov	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Liberals
PassosCoelho	TroikaGov	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals
PiresLima	TroikaGov	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTmarginal	Liberals
S.Monteiro	TroikaGov	FAN	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals

Source: By the author

Three elements are not as homogenous within the group. Former vice-PM Paulo Portas, the Ambassador Duarte and the former Minister Pires Lima believe that COFDI motivations go beyond economic ones and that COFDI generates at least relevant political goodwill.

The red cluster – "The Skeptics" – is composed by the qualifications: PT relevant, PTBiz, NoFAN, M/R/A, Geopolitical, 2MUCH_butINEVITABLE and >Goodwill (Figure 151).

Figure 151. Individuals from cluster 3

Who	Role	Support	Motivation	PIP	Privatization	PT Relevance	Cluster
A.Mateus	M/R/A	NoFAN	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
C.Magno	M/R/A	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
CostaEco	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
F.Ilhéu	M/R/A	FAN	Strategic	GOODWILL	NA	PTrelevant	Skeptics
F.Ulrich	PTBiz	NoFAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
J.Júdice	M/R/A	NEUTRAL	Economic	>Goodwil	2MUCH_butINEVITABLE	PTmarginal	Skeptics
L.Cervantes	PTBiz	FAN	Geopolitical	>Goodwil	NOT_2MUCH	PTrelevant	Skeptics
LMM	M/R/A	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
MTCoelho	PTBiz	FAN	Geopolitical	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
N.Machado	PTBiz	FAN	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Skeptics
N.Rogeiro	M/R/A	NEUTRAL	Strategic	>Goodwil	2MUCH	PTrelevant	Skeptics
Parpública	TroikaGov	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	NA	Skeptics
PFSoares	GovLeft	NoFAN	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
SousaTavares	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	PTrelevant	Skeptics

Source: By the author

The individuals in this cluster tend to consider COFDI as geopolitically driven and a potential source of political leverage, which goes beyond *goodwill*. This does not mean that they do not support COFDI in Portugal, because some do. Despite the risks of COFDI, some believe that it can be used as a "small threat card" in dealing with the EU and the USA. Half of them believe that Portugal privatized too much but that was inevitable.

The fourth and last cluster – "The Moderates" – includes the qualifications *NEUTRAL, GovRight* and *Economic* (Figure 152). These individuals tend of be right-wing, with an interested yet moderate perception about COFDI. None opposes COFDI but neither believe that COFDI is economically motivated and not a source of PIP. Less than 50 percent appreciated the degree of privatization that took place.

Figure 152. Individuals from cluster 4

Who	Role	Support	Motivation	PIP	Privatization	PT Relevance	Cluster
C.Silva	GovRight	NEUTRAL	Geopolitical	NA	2MUCH	PTrelevant	Moderates
CasHenriques	GovRight	FAN	Economic	GOODWILL	NOT_2MUCH	PTrelevant	Moderates
DuraoBarroso	GovRight	FAN	Geopolitical	GOODWILL	NOT_2MUCH	PTrelevant	Moderates
J.Arnault	GovRight	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Moderates
M.David	GovRight	FAN	Economic	GOODWILL	2MUCH_butINEVITABLE	PTmarginal	Moderates
MarceloRS	GovRight	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Moderates
N.Santos	M/R/A	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTmarginal	Moderates

Source: By the author

In the following subsection, each question is analyzed individually and in lengthier detail. It seems agreeable that, based on the results presented thus far, the perceptions of key Portuguese stakeholders about COFDI are skewed towards appreciation for COFDI, even if many of them would prefer to have it in less sensitive sectors, or without controlling stakes, or in proportionate size to FDI from other origins. In other words, the national consensus is somewhere around the idea that **if properly managed COFDI is valuable for the country - it should be steered and scrutinized, but not mitigated or banned altogether.**

7.d.v. The aggregate reply to the key questions about COFDI

Building upon the "structured" coding methodology described earlier, the perceptions about COFDI were organized around nine themes which are answered individually in this subsection.

1. Are you supportive of COFDI?

Only three respondents oppose COFDI and 69 percent are supportive. There is a general endorsement of COFDI in Portugal. Even the (three) *non-fans* do not oppose it strongly. Dr. Filipe Soares is among them and he does not differentiate COFDI from non-Chinese FDI and is cynical about this comparison: "one can see the same level of state intervention in the back-scene when the investment comes from Germany or the USA". He is critical of all FDI in strategic assets because they should be owned by Portugal. Mr. Ulrich was against COFDI, but gradually changed his mind: "having said in 2013 that they should not have sold the 25 percent of EDP to China, maybe in 2019, I might say that they did well, since nothing catastrophic happened". Additionally, "now I realize that obviously we have to live and play these balances with China. On the one hand, to make up for some USA decline. On the other hand, if we have a good and important relationship with China, it gives us some weight in the EU".

Regarding the neutrals, only three out of eleven believe that too much was privatized (Figure 153).

Figure 153. Individuals neutral about COFDI

Who	Role	Suppor	Motivati	PIP	Privatization	PT Relevan	Cluster
CostaEco	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH	PTrelevant	Skeptics
J.Júdice	M/R/A	NEUTRAL	Economic	>Goodwil	2MUCH_butINEVITABLE	PTmarginal	Skeptics
N.Rogeiro	M/R/A	NEUTRAL	Strategic	>Goodwil	2MUCH	PTrelevant	Skeptics
Parpública	TroikaGov	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	NA	Skeptics
SousaTavares	M/R/A	NEUTRAL	Geopolitical	>Goodwil	2MUCH_butINEVITABLE	PTrelevant	Skeptics
C.Silva	GovRight	NEUTRAL	Geopolitical	NA	2MUCH	PTrelevant	Moderates
J.Arnault	GovRight	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Moderates
MarceloRS	GovRight	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTrelevant	Moderates
N.Santos	M/R/A	NEUTRAL	Strategic	GOODWILL	2MUCH_butINEVITABLE	PTmarginal	Moderates
PassosCoelho	TroikaGov	NEUTRAL	Strategic	NO_PIP	NOT_2MUCH	PTmarginal	Liberals

Source: By the author

Dr. Rogeiro says that “at the time, not even the USA opposed COFDI”. Several of them (Dr. Júdice, António Costa ECO, Dr. Sousa Tavares) recognize the influence potential but believe that COFDI can be used as a “small threat card” in dealing with the EU and the USA. Former President Cavaco Silva and former PM Passos Coelho are both agnostic because they prefer to exclude the “origin of the capital” from the decision. The former President would prefer to keep a handful of large Portuguese-owned corporations in Portugal and in its stock market.

Now that it has been established that the opposition to COFDI is weak, it is interesting to find out what drives the appreciation for COFDI. 68 percent of the supporters appreciate COFDI despite the inherent strategic or political benefits obtained by China. Dr. Marques Mendes identifies five reasons for supporting FDI. First, the practical reason: it started when Portugal really needed to attract FDI and no one else was available. Second, there was the historical reason: Portugal is the EU country with the easiest, deepest, and smoothest relationship with China. Third, the strategic reason: COFDI has a long-term perspective, which provides stability. It is an investment which privileges Portuguese management, allowing to incorporate the local knowledge, experience and sensitivity. Fourth, there is a competition reason: COFDI helps to diversify away from the dependence on European and American FDI. Finally, there is the opportunity reason: COFDI tightens the relationship with China which opens the door for exports to its gigantic market.

Many interviewees think of COFDI in (positive) contrast to Spanish FDI, which invariably turns the Portuguese targets into subsidiaries:

> “FDI in Portugal can be divided in three types: Spanish FDI, COFDI and all other FDI [...] Because the Spanish FDI comes from just across the border, which means that everything related to R&D centers is likely to move to Spain. Whenever the Spanish acquire a company here, they treat it as a commercial distributor. The same does not happen with other types of FDI.” Quote from Nicolau Santos.

2. Is China relevant to Portugal (and the EU)?

All respondents agreed that China's rise made it very important to Portugal (and the EU), mostly because of the Chinese COFDI capacity during the crisis. Even Dr. Soares says that "one of the roles of the Portuguese Government is to go around begging for capital […] and in that sense China is, among the economic powerhouses, the one more likely to invest here". Second, the potential of being a large exports market: "China is a very large market for the Portuguese companies, any product which can be certified in China and is allowed to be exported gets a tremendous commercial boost" (quote from Dr. Pires de Lima). Dr. Albuquerque says that "accessing a small niche in China may be a very relevant destination for Portuguese companies".

Dr. Júdice argues that China is a good "small threat card" already played in the past:

> "The Chinese card is a curious one and was first played by Salazar. At some point Jorge Jardim, someone of Salazar's inner circle, was sent to evaluate a potential alliance with the Chinese, which could include the Lages military base. Naturally, the primary objective was to scare the Americans. Recently, we have also had Xi Jinping stopping over at the Lages base, to remind the Americans of the alternatives […] China is important to Portugal in the sense that it may allow us more autonomy from those who rule over us. A small threat card." Quote from Dr. Júdice.

Dr. Monjardino, Dr. Cervantes and others agree with the *threat card* logic because it "allows the EU to be the third side in a bipolar world between China and the USA" (quote from Dr. Sousa Tavares). China is probably the most accessible economic powerhouse to Portugal:

> "Despite the fact that we are NATO members, we do not have the same political proximity with the USA. In the last 40 years we met the president of USA on the highest political level infinite times less than the Chinese, and one can add the Brazilian president". Quote from Dr. Martins Alves.

Former PM Passos Coelho mentions that China is not a critical vector of Portugal's foreign policy, but its spectacular growth makes it an unavoidable power with whom it is important to keep a close relationship. The Portuguese Ambassador in Beijing maintains that "following China closely is following closely the evolution of the world. Economics are important, but it

is much more than that. And Portugal needs to maintain a bilateral relation with China and keep track of what they are doing".

In summary, there is a consensus about the importance of COFDI when it arrived. Beyond that, some interviewees value more the exports' potential and others value more the *threat card* that China can play in the relationship between Portugal, Brussels, and the USA. But everyone recognizes that China is one of the most important powers and it would be illogical to waste the advantage that comes from the long-lasting relationship created via Macau.

Most of the respondents also mention that China is important to the EU, some favoring economic reasons, and others more interested in the political angle of it:

> "From the EU side, it is important for its affirmation in the world and for commercial purposes. From the China side, you have a third factor which is to use the EU as counter-weight in its battles with the USA and Japan" Quote from Dr. David.

President Marcelo considers that both the USA and Russia want a weak EU, and for China a strong EU is better, which aligns their interests. Former President Cavaco Silva agrees that "China defends the EU a lot. Even to have an interlocutor that balances against the USA. And it defends the EUR, to have a currency which counterweights the USD, and does not oppose the Yuan becoming a relevant currency".

Overall, China is important to the EU for both economic and political reasons and the EU needs to be wise in managing this relationship acknowledging its security alliance with the USA, but also aware of the differences between the American and the European interests.

3. Is Portugal relevant to China?

A large majority (73%) of the interviewees believes that Portugal is more relevant to China than what its economic size could indicate (figure 154).

Figure 154. Perceptions about Portugal's relevance to China

Clusters	PT marginal	PT relevant	Total
Liberals	6	4	**10**
Moderates	3	4	**7**
Skeptics	1	12	**13**
Statists	1	9	**10**
Total	**11**	**29**	**40**

Source: By the author

Notably, only one of the "Skeptics" (Dr. Júdice) and one of the "Statists" (Dr. Martins Alves) believe that Portugal is not relevant. The perceptions from the other two clusters are more even. Dr. Júdice believes that the Portuguese language can be important to China, but Portugal is "not that important to China". It can be a useful card for the Chinese

> "but just because we are part of the EU. China does not need Portugal as a disembarking area, because they do not want to dominate the world. In Toynbee terms, they do not want to create an ideology which is a universal religion – like the USA does and the USSR used to do. The Chinese want to be central in the world, want the other countries to pay tribute but do not want trouble from far-away." Quote from Dr. Júdice.

Dr. Martins Alves agrees that Portugal is not relevant "at all". It just happens that "the same logic applied in other parts of the globe can be applied here easily. They look for know-how, they look for dispersion of strategic interests in added value companies for reputational credibility and dispersion across latitudes".

Dra. Alarcão believes that Portugal's size makes it irrelevant: "The size of our economy and our limited political power made their presence in Portugal somehow irrelevant". Dr. David agrees. Dr. Arnaut believes that Portugal was not relevant but became relevant by allowing China to access sectors closed to them elsewhere. Dr. Pires de Lima also believes that

> "Portugal is a marginal country for the Chinese. Of course, Portugal was an important entry market for some Chinese companies in the last ten years, in energy, banking and insurance which gives an economical importance of Portugal above our dimension… were able to execute investments in Portugal with a profile which was not available to them in other European countries." Quote from Dr. Pires de Lima.

Dra. Albuquerque agrees: "Portugal became relevant to China for approaching COFDI without prejudice", and Ambassador Duarte uses the same measure: the "relevance of Portugal is

proportional to the COFDI in Portugal in comparison to other countries. Portugal is between 8th and 10th place in COFDI in the EU". Dr. Filipe Soares defends that China wants to use the case of COFDI in Portugal as an example of peacefulness and cooperativeness.

While the importance of COFDI is singled out by most of the respondents, some believe that Portugal is relevant to China beyond the openness to COFDI. Dr. Mendia mentions that the Chinese appreciate Portugal's diplomatic abilities at the UN and both Dr. Paulo Portas and President Rebelo de Sousa believe that Macau will play an important role as HK loses relevance over time. President Cavaco Silva says that already Jiang Zemin understood that there were the "potentialities to the Chinese exports", namely "taking advantage of our presence in the African CPLP and the good relationship with Brazil". Also, Professor Ilhéu stresses the access to the CPLP: "from Portugal, it is possible to establish connections to other parts of the world. Not only to Europe, but also to Latin America and Africa". PM António Costa shares that "China looks at Portugal as a country that has a special relationship with several countries in geographic areas that are strategic to China, namely Africa and Brazil".

Mr. Relvas believes that China values more the EU angle than the African access: "They came to study Europe where they thought it was less organized, easier to enter, smaller and with less risk. If they lost something here, it would not be meaningful."

Dr. Nuno Rogeiro argues the opposite,

> "I think Portugal is not important for China (as I already heard without proof) as an entry door to the EU. Nowadays, China has several entry doors for the EU, it does not need Portugal for that. But China needs Portugal for another thing, and that is why it created an entity in consensus with Portugal, which is a bridge between Portugal and the CPLP." Quote from Dr. Rogeiro.

Dr. Lacerda Machado agrees: "the CPLP are not strategic to China, they are vital, which is much more than that".

Dra. Lin Man sums it all saying that China values Portugal above its fair share because it works as a platform for acquiring know-how in strategic sectors and for accessing new markets, while being very welcomed in a relationship which dates back five centuries through Macau.

4. How does COFDI and China fit into the Portugal-USA relationship?

There is no consensus about how to deal with COFDI in the context of the relationship with the USA. Dr. Mário David says that

> "EU foreign policy is more and more independent from the USA. It is true that most of the countries are atlantist and share more fundamental values with the USA, but foreign policy is much more driven by real politik than other considerations. Much more so with the Trump administration… if there is a military issue in the Sea of Japan we will always be on the side of the USA, but outside the military, there is no coordination." Quote from Dr. David.

Dr. Arnaut believes that Portugal needs to coordinate with the EU its relationship with China, but the USA should not play a major role in that: "this idea of individual countries, like Portugal, acting standalone does not make sense. At the same time, as far as we are concerned, the commercial war between the USA and China does not involve Europe and there is a balance that should be kept and preserved." Likewise, Dr. Nicolau Santos believes that Portugal will maintain proximity with China despite respecting the alliance with the Americans:

> "Portugal and the USA are slightly drifting apart, despite not being very explicit in the public communication. It seems to me that Portugal will keep its non-critical stance towards China. Historically we have always attempted to diversify and balance our dependencies and friendships." Quote from Dr. Nicolau Santos.

Dr. Barroso demands better involvement of Portugal with the EU but also with the USA regarding China: "Portugal, by itself, is not enough to rebalance that relationship. It has to do it at least in the EU scope, and ideally within a strategic concertation with some of our partners, namely the USA*"*. President Marcelo also states that Portugal understands and empathizes with

the American perspective and considers that Portugal's crucial ally demands from it things which are not in its economic interest (e.g., regarding 5G).

Several respondents (Dr. Júdice, Dr. Monjardino and Dr. Tavares) appreciate the "small threat card" potential of COFDI in the relationship between Portugal and the USA and argue that Portugal should use it. Both Dr. Rogeiro and Dr. Albuquerque remind us that not even the USA opposed COFDI when it arrived at the time of the financial crisis:

> "The relationship with the USA is not as relevant as we could wish. In our case, during the EDP sale process we had to interact with the American authorities. They asked the questions they needed to ask, and they did not oppose it. It was a very smooth interaction." Quote from Dr. Albuquerque.

The view of the Portuguese Government regarding China is clearly articulated by the MFA:

> "We are partners, not allies. We are already cooperating, and may extend our cooperation in diplomatic, educational, cultural, and economic terms, but we are not cooperating bilaterally in matters of defence and security, nor are we aligned in terms of geopolitical and strategic positioning. In these areas, the collaboration framework is the UN." Quote from Professor Santos Silva.

The Ambassador to China puts it similarly:

> "Portugal never participated in a military conflict against China, even when China was defeated twice by a coalition of European powers […]. Our strategic tradition of foreign policy is that, and we continue to honor it […] Portugal does not confuse friends with allies, but also does not presume as enemies the enemies of our friends. We do not need to import the conflicts of others." Quote from Ambassador Duarte.

Professor Adriano Moreira amusingly reminds us that Portugal's relevance to the USA derives from "that security thing call geography" as proven during World War II, when Portugal was able to maintain pure neutrality in a peculiar manner:

> "We reached an agreement. There is a part of the country (the islands) which is compromised with the Allies. The rest is neutral. The lawyers will have a hard time understanding this. Full stop. But that is what it is. Full stop." Professor Moreira in his interview quoting the President of the Assembly Council during World War II.

5. What are the motivations behind COFDI in Portugal?

The perceptions about COFDI motivations are categorized in three levels. *Economic only* – when the respondent believes that COFDI was driven purely by economic return on investment; *Economic/Strategic* – when, beyond the economic returns, the Chinese are presumed to be using Portugal as a platform for accessing other geographies or important know-how otherwise unavailable; *Geopolitical* – when COFDI was also driven by the pursuit of political influence or other geopolitical objectives.

Figure 155 shows that half of the respondents preferred the middle option.

Figure 155. Individual's perceptions of motivations

Cluster	Economic only	Economic/Strategic	Also geopolitical	NA	Total
Liberals	3	5	2		10
Moderates	2	3	2		7
Skeptics	1	6	7		14
Statists	1	8	1	1	11
Total	**7**	**22**	**12**	**1**	**42**

Source: By the author

Among those qualified as *Economic-only*, two consider that Portugal is relevant for China, and the irrelevance of Portugal partly explains why the others believe that COFDI was opportunistic. Mr. Relvas was included in this qualification, but he could have also been inclued in Economic/Strategic. He believes that there was "no approach to Portugal", the Portuguese assets were considered affordable and potentially usable as a cheap and safe platform for learning about Brazil and the EU. But the Chinese have not yet used their targets to attack those two markets (which, for him, partially refutes the "platform hypothesis").

Dr. Magalhães Correia says that "there is always the idea that the Chinese want to get access to our technology […] but they do not need it". Dr. Júdice argues that "COFDI in Portugal is opportunistic. It is not done with a political/strategic rationale. Off course state investments always have a little bit of that, but not much", and Dr. David says that "there is no space for political motivations because of the low political relevance of Portugal".

The *Economic/Strategic* qualification is prevalent, and the rationale for COFDI is always access to technological know-how or a way to gain access to new markets (Africa, the EU, Brazil, and/or the USA). President Marcelo believes in strategic motivations: "Strategic? Yes. Good opportunities? Also". PM Costa agrees:

> "They have the possibility to articulate with other regions in the world, which have not been working out so well […] but the reality is that they also invest to acquire know-how […] when they invested in the Portuguese energy market we were at the technological forefront of renewable energies, and this was absolutely critical." Quote from PM Costa.

Dr. Mendes believes that the Chinese care the most about the EU angle and want to make the COFDI in Portugal a poster case in the EU. "It is not philanthropy. It is a strategic move."

Dr. Portas stresses the geo-economic drive: "they want to advance, not only to make money […] in certain technological sectors they have the impetus to leapfrog, to expand."

This group believes in the importance of the historical relationship: Portugal is perceived as a safer market where the Chinese feel respected. Dr. Magno says that "they want it for investment and strategic reasons, but also because they believe they can establish good relationships".

What distinguishes this group from the next is the refusal of political motivations. As an example, Dr. Albuquerque says that "there is no motivation to influence our political regime" and Dr. Salgado says that "there is no evidence of political motivations".

Twelve individuals believe in "geopolitical motivations" and half of them dislike COFDI. The cornerstone about geopolitical motivations is the state ownership. President Cavaco Silva explains that "it must be assessed if, behind, there is a private group or a political power, because that is where reasons of geopolitical nature start to manifest themselves". Dr. Barroso believes that "China remains consistent with its political and ideological model, it still thinks that politics overrules economics". Dr. Soares believes that "the political interests derive from an economic model (State Capitalism) which can use MNE to condition political decisions and avoid criticism to internal suppression of freedoms and political regime". António Costa ECO

still differentiates state-owned from private investments "the state investment from SOE is clearly a political investment […] in the private investments the business rationale weights more".

6. What type of political influence can China achieve through COFDI in Portugal?

The prevailing perception is that COFDI provides China with a mild form of political influence called goodwill (Figure 156).

Figure 156. Individual's perceptions about COFDI's PIP

Clusters	>Goodwil	GOODWILL	NO_PIP	Total
Liberals		5	5	10
Moderates		5	1	6
Skeptics	8	6		14
Statists	2	9		11
Total	10	25	6	41
	24%	61%	15%	

Source: By the author

15% of the respondents, all related to the right-wing Government during Troika, believe that COFDI is overrated, because it does not necessarily provide China with material political leverage. They defend that leverage depends on the ethics of the public officials:

> "There is too much fiction and disinformation regarding the risks associated with COFDI. I understand the hypothetical risks of political influence, but first, we will not sell the entire economy to Chinese owners. Second, they are more a function of the ability of the governments to know their place than of the Chinese intentions. Intentions are not enough; they would need a counterpart. And if they can find counterparts, they do not need investment." Quote from Dr. Albuquerque.

For some, COFDI fosters the alignment of interests but does not make Portugal forget its own:

> "I do not believe that they hold significant leverage over the Government. In some cases, they may align with Chinese demands, just like many times the Government does not. Our Government or the current one. China is an important partner, with whom we maintain a good relationship for as long as that is interesting." Quote from Dr. Alarcão.

Former PM Passos Coelho agrees: "Neither COFDI nor any other FDI has ever been a constraint to the political decisions in Portugal […] in a political or diplomatic manner". Dr. Monteiro

does not see any Chinese influence or lobbying attempts. “I do not feel that there is a lobby. There are no spearheads of COFDI in Portugal, at least they are not very visible”. Mr. Arnaut argues that “the Chinese state policy has not been about using Chinese companies in pursuit of political objectives. They are interested in capturing economic advantages, opening markets and use their investments to support the internationalization of Chinese companies”.

On the other extreme, there are 10 individuals (24 percent) who believe that China already holds relevant political influence, which goes beyond goodwill and is operationalized via active interest groups formed by influential individuals who are economically incentivized to defending China’s interests. Dr. Rogeiro explains that China does not have active influence over the political regime but is interested in avoiding negative media:

> “there are two kinds of political influence: a negative and a positive one. I do not think that they can use any kind of veto to start doing influence campaigns in the EU, like, ‘let’s transform the EU, from an economic union into a political union or vice versa, or let’s force the states to leave the EU’. But a negative campaign yes, so China can want the Portuguese political parties to form a consensus and stop saying bad things about China. The official Chinese problem is this: ‘one day we will have the same problems that you have about civil rights, but for now, we still have to figure out the problem of the economic rights’. What is relevant for them is that China’s image is not destroyed. This is what we can call a ‘negative veto’. The positive veto, to advance a campaign to transform the EU, I do not believe”. Quote from Dr. Rogeiro.

Dr. Monjardino explains that influence is secured through the influential individuals who are hired by the Chinese to represent them in the invested companies:

> “anyone understands that when someone has a lot of economic power, they eventually have political power. That happens here as well. Obviously not directly, but indirectly. Because the people they hire here to represent them are normally influent people who eventually influence political power on their behalf”. Quote from Dr. Monjardino.

Dr. Miguel Sousa Tavares has the same opinion:

> “The political influence over the governments is done through the people they nominate to their COFDI targets […] When they arrived at EDP, they kept Mexia, but then they nominated people from the relevant political parties. They hired António Vitorino from

> PS, Celeste Cardona from CDS, Braga Macedo from PSD, and Eduardo Catroga. They cherry picked ambassadors from each party without knowing if the selected few had the capabilities to manage an electricity company". Quote from Dr. Tavares.

Dr. Martins Alves acknowledges that the Chinese influence has grown significantly but even if the Chinese Ambassador asks for support in preventing critical documentaries being aired that does not mean that he is successful. Dr. Soares is certain that COFDI provides political influence because any of the strategic companies owned by the Chinese state already had pressure capabilities before acquired. Dr. Júdice believes that power in Portugal is very fragmented, and no one can have dominant power. But veto power is possible, and the Chinese already have some. But they are not very keen on having too much power due to the irrelevance of the country:

> "Anyone who wants to have political power needs economic power and control over the media. I do not see the Chinese getting involved in the media […] if the Chinese would want to have political influence, they would be buying media companies, and that would be extremely cheap for their standards." Quote from Dr. Júdice.

Off the record, many respondents name concrete PR/lobbying agencies which are hired by Chinese interests to actively engage the media in promoting pro-China coverage and limiting the anti-China articles. These practices can only be identified via denunciation because corporate sponsorship tends to flow via intermediaries. about the same happens in regards to political parties' financing, many mention that, from the existing records, it is impossible to prove a link because the maximum individual donation forces the fragmentation of the financing vehicles and the usage of *frontmen*.

Most of the interviewees believe that China acquires some political goodwill via COFDI, but they downplay its relevance. China has its own interests, which sometimes coincide with the Portuguese interests. When they do not, China voices its concerns but that is usual in diplomacy:

> "Having a friend in personal life is like having a friend in diplomacy. We are friends and we agree on many fundamental things, but we disagree on some things. China has

been supporting Portugal in many ways, and Portugal is thankful for that. But that does not mean that we have to agree on everything." Quote from Ambassador Duarte.

COFDI and trade with China increase Portugal's interest in having smooth relations:

> "It becomes the best interest of Portugal, given that the COFDI is high and the Portuguese companies are increasingly exporting to China, that we maintain a friendly and close relation with China. There is goodwill in the political relation created by this economic relationship". Quote from Dr. Pires de Lima.

Dr. Mendes believes that "Portugal is not running any risk of losing its sovereignty. We need to take advantage of what is to be gained from these investments and not worry in excess with those theoretical risks". Moreover "the Chinese [do not] aspire to change our ways of living, I recognize that some Americans believe in that, but I think they are a minority in their country". President Marcelo agrees with that.

Professor Ilhéu states that **"**the economic world has always influence over the governments, regardless of who they are. It is very difficult not to have. In democracies, in the Western system where we live – even in others – it is not possible to separate these realities […] and the same is true with the Germans and the French".

Dr. Barroso believes that there is no threat to the national sovereignty:

> "I do not see how COFDI represents a bigger threat than any other FDI which is closer to us geographically. The state keeps regulation and intervention powers, and, if necessary […] Portugal has intervention possibilities. The Chinese Government will not remove Portugal's electricity or distribution networks, will not and could not do it, even in an extreme situation" Quote from Dr. Barroso.

For him, China has no "intention to control the Portuguese state" but it is legitimate to ask the question whether China is already capable of limiting criticism from the Portuguese press:

> "The political pressure argument is real, and I wonder if we, in Portugal, are not already in one of those situations. This happens for either one of two reasons: because there is a more moderate Portuguese position in order to avoid conflicts with stronger powers?, or because this is the result of an effective economic influence in the Portuguese political system? I do not know, but it is a legitimate question*".* Quote from Dr. Barroso.

Mr. Ulrich provides a good summary of the overall feeling among key stakeholders:

> "Sometimes, there are ways to have indirect influence. Let's assume that the Portuguese people, whom they respect and trust, understand better the Chinese interests and due to that (I say it honestly, I am not speaking about corruption, because there are a lot of ways to do that) they become ambassadors of China in the same way that I am now chairman of BPI, which is 100 percent of the Caixa Bank, and I am ambassador of some Spanish causes. That is normal and healthy. Reputable and credible people who understand them better and are friendlier, that generates goodwill. They have it more today than they did 10 years ago, but it is not yet a relevant factor in Portuguese politics". Quote from Mr. Ulrich.

7. Did Portugal privatize too much during the Troika period?

The interviewees are divided on their perceptions about how much was privatized during Troika (Figure 157). One third of the respondents believes that too much was privatized, another third believes the opposite, and the remaining third believes that too much was privatized, but that was inevitable under the circumstances.

Figure 157. Individual's perceptions about Privatizations

Clusters	2MUCH	2MUCH_butINEVITABLE	NOT_2MUCH	Total
Liberals		1	9	10
Moderates		3	3	6
Skeptics	4	8	1	13
Statists	9	1	1	11
Total	13	13	14	40
	33%	33%	35%	100%

Source: By the author

This dimension seems correlated with the definition of the clusters, since none of the "liberals" nor the "moderates" believe that too much was privatized and nine out of eleven "statists" believe that too much was privatized. As Mr. Relvas synthesizes: "the left privatizes in order to gain money, the right privatizes because it thinks that the management is better". Among the liberals, only Dr. Portas says that too much was privatized, but inevitable. The others agreed with the privatizations out of necessity, but also because the state is a poor manager, because selling public assets would pave the way for more FDI from the same geographies, and also for the belief that good regulation was feasible:

> "A bankrupt country needs money and there is no doubt about it. But we have always wanted more than that, we wanted to go beyond. And there we can see an ideological difference. We believe that what matters is that the services are provided with the best quality, highest efficiency and best management. And since we are talking about regulated sectors the Government retains the power through regulation, it does not need to own the service providers. If the rules are not respected the state can intervene. Beyond the sales proceeds, we had the intention to open the economy and attract investors which would not otherwise become interested in the Portuguese economy. The need for capital is transversal across the economy and the state owned just a piece of the pie. By selling some of its companies, the state opens a road for some of these investors and sends out the message that the FDI is most welcome. The COFDI started with the public companies, in the privatizations, but after it continued to the private economy." Quote from Dr. Albuquerque.

Former PM Passos Coelho focused more on the necessity argument and reiterates that the financial envelope provided by the Troika was insufficient and the main solution to that problem was to sell more and "better" than expected.

On the other extreme, the "statists" align on the idea that too much was privatized. Even if they understand the necessity to alienate some assets, there are some cases which clearly did not pay off. They do not agree on which privatizations were more harmful. Dr. Soares and Dr. Lacerda Machado criticize EDP, REN and ANA privatizations:

> "I wonder why EDP is privatized. The public debt needle did not move, and the Portuguese state lost one strategic position. Why was the Portuguese airport infrastructure monopoly handed over for 50 years to a company that paid shamefully little for it, to say the least? Why should TAP be handed over for basically nothing?" Quote from Dr. Lacerda Machado.

Dr. Caldeira Cabral opposes the privatization of REN: "I think the mistake was to privatize REN […]. The regulation that resulted from REN's privatization, is unfavorable to the country and to the technological evolution". Professor Brilhante Dias agrees. PM Costa understands some privatizations but misses some strategic assets, such as a state-owned telco. Dr. Alves believes that COFDI was not properly steered. The concessions of new infrastructures should have been prioritized.

The clusters less associated with the PS and the PSD governments ("skeptics" and "moderates") are less critical of the privatizations. They consider that the country was desperate and not even the USA opposed COFDI. Dr. Rogeiro argues that "back in 2010, the Americans did not oppose the sales to Chinese investors". The Portuguese companies were outside the financial markets and the privatizations helped re-establishing the country's financial creditability. At the same time, they tend to believe that privatizations are good if they respect some important requirements beyond the price, namely (1) solid governance, (2) proper regulation, (3) non-state ownership, (4) and from a diversified base of geographies of origins:

> "We have a dramatic problem in Portugal which is the lack of capital. If the alternative is to be in the Portuguese state's hands or some investments, well sold, with good governance and controls, done by several investors, from several countries and not held by their state, I think I prefer this second scenario, since there is no capital, than having everything public or owned by one single country". Quote from Dr. Nelson Machado.

Overall, it is consensual that privatizations were necessary and there was support for the program in general. Simultaneously, everyone seems to be aware that the Chinese were much more capitalized and interested in the program than other countries. That made it natural – not inappropriate – that China acquired a lion's share. At the same time, some specific investments were not consensual because they are hard to execute and regulate in practice. The main specific concern is about having REN and EDP in the hands of the same owner (Chinese state). Even members of the 2011-15 Government doubt the merits of that decision.

8. Should Portugal be willing to allow Chinese presence in Sines or in Lages?

Sines and Lages were the most debated topics about sensitive Chinese ownerships in Portugal at the time of the interviews. The 5G topic gained emphasis later so it is not covered here.

Only 15 respondents shared their perception about a potential concession of one of the terminals in the Sines deep-water port, where the Port Singapore Authority already operates one terminal. Everyone agrees with a Chinese presence provided that there are bullet-proof contracts

defending the national interests. At the same time, all the respondents presume that this will be an important point of dispute between the USA and China because both sides would have a lot to gain from securing this gateway. Dr. Tavares says that "a relevant deep-water port is decisive for Europe and for the maritime traffic. That is a global strategic position". Dr. Júdice highlights that "if it is true that the Sines Port is the largest deep-water Port in Europe, then Sines is important". Dr. Lacerda Machado confirms that "Sines will either be the arrival point of the Silk Road or the gateway for our American neighbors". Dr. Monjardino rejects any danger about Sines, but demands solid contracts:

> "They need Sines in purely commercial terms. I am convinced that they will not station their submarines or aircraft carriers, they cannot do it. But obviously we cannot facilitate too much the conditions in which we deliver the Sines port and sometimes we have that tendency, when good money is on the table". Quote from Dr. Monjardino.

The question remains if either side will be willing to invest in Sines. PM Costa confirms that the USA has been "voicing concerns about the Chinese presence in some critical infrastructure, which has been resulting in an attempt from their side in mobilizing American investors to compete with the Chinese in Portugal. I await with interest to see of these concerns materialize in an interesting competition or if the words will fly with the wind".

Dr. Rogeiro advances that even the Chinese interest is not confirmed:

> "A potential entry of COSCO in the Vasco da Gama terminal in Sines will be one of the main points of discussion. It represents 60 percent of the containers in Portugal. And if the Vasco da Gama terminal had a connection either through a bridge or train to the north of Lisbon, it could totally circumvent the Lisbon port. Most of the containers are also in the north of Lisbon. Are the Chinese willing to invest on the terminal and in a special railway? That is the big question". Quote from Dr. Rogeiro.

The Lages case is either not commented or rejected by all respondents except for Dr. Cervantes who says: "I would never support a 100 percent sale, but perhaps a joint venture with the Portuguese state, which, deriving from a clear protocol, could allow a pacific coexistence and avoid the abuse from the dominant position". Dr. Mendes says that "the Americans still have a

presence there and until they get out of it entirely this could not be a possibility. Second, we are part of NATO and China is not part of NATO, this means that we do not get to mingle in military terms". Dr. David agrees: "it is such an important location for NATO that it will always be available for NATO […] we are just not being paid for it as much as before. But it is out of question for geopolitical reasons to give military support to China". Dr. Rogeiro summarizes well the overall Portuguese feeling about the topic.

> "The Chinese were interested in Lajes as a monitoring station for satellites. They have a big spatial program which is in progress, in which they already have sent lunar probes, they have now a project to send a probe to Mars and the Chinese special observation is important. The problem is that in the space industry there is also the difference between civil industry and defense industry. If they send a satellite outside the atmosphere, they can also send a military satellite and that can also be connected to the ballistic programs […] Lajes is a Portuguese aerial base which is lent to the USA. It is not an American base which is lent to Portugal. Therefore, if the USA is not interested in using that structure, they cannot expect Portugal to close or open it whenever they want. Portugal must monetize that structure. There are already several rehabilitation projects in progress there and the USA gave up from the retreat idea and may be close to announce the returning of larger contingents. But we are still in a no-man's land. Honestly, I do not see that China can replace the Americans in that structure. It is essentially a military infrastructure*".* Direct quote from Dr. Rogeiro.

9. Should Portugal or the EU adjust its FDI regulation?

The discussion about FDI regulation can be split in two: (1) determining what can be owned by non-EU investors, and (2) regulating the activity of the investments once executed. Independently from the respondents' agreement to the level of privatizations, everyone demands good regulation of critical sectors. Only 19 respondents shared their opinion about these topics. Regarding the first, this study collected 13 inputs. Like Dr. Mendes, Dr. Júdice believes there is no point in discussing it at the national level: "this matter is in the hands of Brussels. We cannot do anything different from the EU". The experienced regulator, Professor Abel Mateus recalls that the academy has proven that FDI is nefarious in dominant positions:

> "Bhagwati's theorem called *Immiserizing growth* proves scientifically that when there is FDI oriented to a market where there is a distortion of resources, such as a monopoly, that investment will maximize its profitability by extracting rents which will cost the economy much more than the benefit obtained by the sale. In the case of REN, the regulation ensures that the profits are not abnormal, but in the case of EDP there have been abnormal profits, especially through the CMEC and the subsidies for renewables". Quote from Professor Abel Mateus.

None of the respondents argued that non-EU investors are worse than EU investors *per se*. Only Dr. Arnaut argues that there should be stricter rules regarding compliance and origin of funds when the investor comes from outside the EU. Dr. Soares argues that Portuguese investors are preferable to foreigners (EU or non-EU):

> "Domestic and foreign capital are different, because EU capital is always supported by EU regulation which, in general, does not favor Portugal due to its small size. The other countries are used to such regulation and force Portugal to implement EU regulation *ipsis verbis*. The foreign governments pressure Portugal via DG COM or other European instances. If the investor is Chinese, the pressure is exerted in a different way, but exerted nonetheless. From that point of view, in practice, the domestic capital is better because it is smaller, easier to defend from". Quote from Dr. Soares.

The PSD (Troika) Government published a strategic sectors' degree-law. Dr. Alarcão says that it defines "the strategic assets. It is a weak decree-law but exists and perhaps could be improved". Dr. Monteiro explains that Troika was defensive about that decree-law: "They believed that it was an invitation for future hidden golden shares, but this decree was part of the global architecture of our policy, so we pushed for its approval*."*

Another concern relates to the reduction of local economic activity when foreign ownership is followed by a loss of decision relevance in the invested company:

> "I am one of those who believe that some areas should be more regulated because the market does not regulate itself. In the energy sector […] I believe that foreign ownership may misalign the interest of the company with that of the Portuguese Government and limit the Government's strategic toolkit." Quote from Dr. Nicolau Santos.

PM Costa, Ambassador Duarte and the President of AICEP argue that there is enough regulation of FDI ownership. They believe that the impetus to restrict further non-EU FDI reduces the competition to EU companies in bidding for Southern European assets. Dr. Castro Henriques says that "further limitation reduces the number of bidders to our assets and that automatically results in lower bids". The PM reminds us that if we did not accept non-EU investors, REN would have been sold for 25 percent of the price. Ambassador Duarte believes we need to discuss where to draw the line and why:

> "Is China worse than Spain? What is the rationale for that? The critical point is to define clear rules and regulation and follow those. Of course, I agree that our sovereignty is weakened after three interventions by the IMF, and after so many companies were sold to foreigners. The weakening of the Portuguese economic sovereignty is a problem, but it happens no matter if it is the Spanish or the French or the Americans or the Chinese purchasing the assets […] In this debate we need to defend our interests and not behave as pawns in the geopolitical chessboard." Quote from Ambassador Duarte.

Regarding the topic of regulatory effectiveness there were 11 inputs, half of which from the Troika Government. The former PM Passos Coelho remembers the complexity of the REN case: "Because the state's competences in the field were being alienated with the asset, it required a judgement call about our ability to regulate it. I believe that it happened. I cannot swear that it is eternal, but we strived for that". Dr. Alarcão believes that contracts are never perfect, but the Government tried to safeguard its position: "We did our best in establishing strong concession contracts and maintaining good regulatory bandwidth. People may point the finger at the contracts and complain about x and y, but that is true regarding any contract". Dr. Cabral feels differently: "The regulation that resulted from REN's privatization is unfavorable to the country and to technological evolution". Dr. Monteiro defends his work: "We always tried to explain that more than the nationality of the capital, what mattered were the contractual safeguards about the service level and the regulatory competences of the state". For him, the problem came next, with the Socialist Government: "The recent captivations keep the regulators

from proactively enforcing the contractual obligations". Regulation has not been working effectively, but the blame is unfairly attributed to the privatization when it is the lack of resources that prevents the regulators to hire capable and independent people. "Parpública" puts a lot of emphasis on this theme, which he personally experienced: "The focus is put on the wrong place. They ask you for 70 papers to open a bank account, but then no one reads the papers. It generates a false sense of security." For him, the real problem is that two terrible conditions are put together: "the nomination process and the low salaries paid do not ensure independence: regulators are totally gagged". Professor Mateus confirms that regulators are "captured by the state. The state nominates regulators who are transmission belts for the Government's interests". The insurance sector was effectively regulated based on the outcome so far. Dr. Cervantes shares that both in terms of supervision (authorization to own the assets) and capital regulation (ensuring the necessary capital to operate), the regulator is effective: "there is strong regulation in terms of origins of capital and availability of capital to deal with future crises".

All in all, the average perception is that discrimination against non-EU investors has the same problems of non-domestic ownership and reduces the pool of bidders, thus reducing the assets' valuations. Professor Teixeira Coelho reiterates that FDI in *tradable sectors* is much more interesting than in *non-tradable ones*. About the country's ability to regulate the sensitive sectors, the feeling is of concern, in the sense that it is theoretically possible to regulate well, but it does not happen in practice, for the lack of competence and independence.

Part 3 – Conclusion

8. Implications

8. 1 Key findings

This thesis analyzes the strategic and political implications of COFDI in Portugal.

It created a framework with the motivations and intended usages of economic statecraft, identifying five "plays" – while plays #1-3 are fair *business-as-usual* in the current world order, there must exist checks and balances to limit the plays #4-5, which are undesirable.

	Hypothetical usage in the future…		
Hypothetical primary motivations…	**Financial /economic objectives** (e.g., rate of return; market access; know-how;)	**Strategic engagement** (long-term goodwill & understanding of sender's interests)	**Coercion or subversion into new political model** (autocracy promotion)
Manage financial portfolio (e.g. rate of return)	1. Pure financial play	3. Economic interdependence play	
Gain economic edge (know-how; market access)	2. Economic strategy play		
Gain political leverage (ability to influence government/public opinion)		4. Strong dependence subtly used for defensive purposes	5. Offensive weapon to be used for advancing new political model

Identifying the existence of undesirable plays depends on semantics: (autocracy) *promotion* differs from *support*; *inclusive* differs from *exclusive* promotion; and political *influence* is different from *interference*. Play #1 is strictly financial, play #5 is outright political warfare, and plays #2-4 are the realm of economic statecraft. China may execute plays #2-3 with non-controlling COFDI stakes, but play #4 and particularly play #5 require controlling ownership.

The theoretical realism-idealism dichotomy in IR was found potentially overstated, since realists can acknowledge the importance of ideal and values, and idealists do not necessarily

reject all geopolitical restraints. Perhaps the global (dis)order became too complicated to be evaluated in polarity terms and China cannot hold enough economic power in Portugal to coerce it. Likewise, it may be a stretch for the USA to prevent the economic interdependence between Portugal and China based on subversion fears, and anecdotal accounts of political warfare going on in distant places. But the right mix of economic and soft power may drive Portugal's interests closer to China's preferences. The co-optation of local elites and influence over the media seem key to that. Therefore, constructivism, i.e., the notion that identities and interests are *socially* co-construct and are not simply given, is an indispensable contribution from IR to this thesis.

Political scientists believe in waves of democratization/autocratization and have proven that powerful states (both democracies and autocracies) are active political interventionists. Their typical tools are covert funding, media manipulation, pre-election public threats and financial promises. Not all autocracies perform interventionism equally: NED uses the term *sharp power* in relation to China, in the sense that it perforates the political and information environments through the manipulation of culture, academia, media and publishing. These political warfare practices (play #5) fall outside of economic statecraft, which is the object of this thesis.

China is governed by the CCP in an increasingly authoritarian manner, and volatile domestic political disputes drive its economic and foreign policy. The fast Chinese economy is slowing down, and its growth drivers are the search for new markets where the Chinese companies can put their experience, workforce, and capital to work, and the acquisition of technology to move China to the forefront of disruptive sectors. This impetus is the main domestic driver of its economic statecraft, including in the EU. The international affirmation, through global economic expansion and regional comprehensive power projection, is becoming a crucial legitimating factor of the rule by the CCP, and economic statecraft plays a role in it as well.

The EU is a family of liberal-democratic states, acting collectively through an institutionalized system of decision-making and its members adhere to a body of rules but also to a set of shared common values. Regarding the foreign economic engagement, the EU and the member states share responsibility. From a realist perspective, the EU does not have enough hard power to engage assertively in high politics and is more of a repository of the second-order normative concerns. But it is an economic superpower and plays a key role in international trade. From a liberalist perspective, the EU is a supra-state governance layer, which enables peace and interdependence, strictly interlocked with domestic politics. From the constructivist perspective, the EU has a strong normative bias that impacts those engaging with it.

The EU supported China's integration into the global economy and tried to influence its strategic culture through engagement. China values the EU as a major trading partner, and a source of technology and FDI. China used the financial crisis turbulence to affirm itself in the world stage, including throughout Eurasia. While the relationship with the USA went sour ever since, the engagement with the EU deepened at first, propelled by the COFDI in the EU. The difference in sub-regional interests became obvious: the richer countries privileged easier access to the Chinese market, whereas countries like Portugal craved for FDI. While there are better companies in the center, in the periphery the value for money is good and no reciprocity is demanded. On the contrary, several EU governments actively touted for COFDI waving with *friendship* in return. On that regard, China's tactic is casting a wide net and watching which fishes try harder to be caught. China secures goodwill among several EU governments, which then serves as a divisive factor, used selectively in the matters closer to China's heart, generally without needing to ask for it. The EU and China have divergent views on democracy, but China does not oppose the EU concept of democracy – what Chinese elites insist is that such model does not fit China. China dislikes EU's pressure on HR and political issues, even if done by the

(independent) media. The EU became more geopolitical and less idealist as it lost hope for Chinese domestic political reform. That does not mean that the EU is seconding every USA geopolitical interest. It may be in its interest to grow as an alternative geopolitical pole, and China probably remains its best hope for economic growth. The normative considerations remain stronger in rhetoric than in practice because China already secured goodwill with enough EU countries to prevent a cohesive opposition. The EU's trade deficit is massive but uneven (i.e., Germany is a clear winner), and the EU population and its political leaders no longer adhere to the free-market fundamentalism they once did.

The USA worries that China's economic development will enable its military modernization and the development of its defence industry, for which the BRI and the *Made in China 2025* are instrumental. The USA and the EU used to be closely interlinked: both adhere to basic free market principles and their economic interactions largely occur within common rules and a shared sense of fairness. And NATO is still the guarantor of the EU's territorial integrity and peace. But the Iraq intervention raised EU's skepticism about the reliability of the USA as a security partner, the Obama administration deprioritized the Atlantic, and then came Trump. In strategic terms, there is a USA-China-Russia triangle, and the EU needs to be understood in relation to it. The USA can no longer be understood as a reliable partner, but there is no alternative to it – a strategic partnership with Russia or China is unconceivable. The EU probably needs to strengthen its own military capabilities. From the economic standpoint, the USA-China-EU is the central triangle, and there is a growing disentanglement between the USA and China. The USA wants the EU to pick sides, but a scenario where all 27 member states agree on this is unlikely. The existing liberal order was created by the West, and its arrangements reflect its preferences and interests, so China wants them to better reflect its own. China must secure the cooperation from other powers in this movement and the EU is China's

best hope. Moving forward, the emergence of two overlapping international orders is possible, each relatively open internally but less open to the other. China wants the EU to prioritize the benefits of continued economic and technological engagement over normative considerations.

Portugal's participation in the EU project was more political than economically driven. By joining the EMU at an unfavorable exchange rate Portugal embarked on a journey of stagnation – the EU meant a phenomenal institutional progress but an economic disaster. Portugal's GDP per capita is diverging from the EU average, being relatively poorer than it was in 1995. The Portuguese economy has many problems, the first being the lack of productivity (of labor), derived from the lack of capital. Capital is scarce because what existed was nationalized in the 1970s, and because the EU structural funds were invested in low-productivity and non-tradable sectors. Portugal has three paths moving forward: (1) finding a *big brother* that invests massively in it; (2) abandoning the EU or the EUR project, default on the sovereign debt and face the grave consequences; or (3) becoming a region within an EU federation which subsidizes it. The first two scenarios are probably not feasible, and the third is embarrassing. The Portuguese foreign policy faces a dilemma: defending its interests vs. defending its values. Portugal wants to deepen its relationship with China, while not being considered too close to China. The USA profoundly disapproves of further sensitive COFDI in Portugal. The Portuguese MFA believes that some circles have erroneously identified a Portuguese over-dependence on China, which is an oversimplified view. The USA record of interventionism undermines its moral superiority on political interference and Portugal has a long-lasting relationship with China, so it does not want to pick sides on economics just yet.

In a strict sense, it is very hard to find evidence of Chinese actions to acquire political interference in Portugal. If the definition is broadened, only requiring evidence that China is

interested in having goodwill in Portugal to have the country's interests increasingly aligned with theirs, then the case is trivial. There is no such thing as a chemically pure democracy, and Portugal should not be naive to see itself as such. Portugal must remain on the watch, particularly about the loosening of horizontal accountability – the monitoring of media and party financing are good places to start. This is true regardless of China and it is stretched to presume that China is promoting the rise of authoritarianism in Portugal. It is common knowledge that China hires Portuguese PR/lobbying firms to mitigate media criticism and tell the Chinese story in its way, but it is not alone in doing so.

The FDI literature has been focusing on business-motivated OFDI from developed countries. COFDI took over the debate and surfaced its limitations. COFDI was <0.5 percent of global FDI stock until 2005, reached 1.5 percent in 2010 and ~5 percent by 2019, but is still less than one third of China's 18 percent share of global GDP. Europe is the largest recipient of COFDI totaling USD ~260 Bn in the last 5 years. Until 2015, Portugal, Greece and Hungary concentrated a disproportionate share of COFDI in Europe, but since then Switzerland, Luxembourg, Finland, Slovenia, the UK and Sweden have caught up. The top 20 investors sum 48 percent of global COFDI since 2005. Among them are four *grey rhinos* ("private" spearheads which purchase controlling stakes in Western strategic assets unavailable to Chinese SOE), which helped reduce the proportion of COFDI performed by SOE from ~80 percent to <50 percent, particularly outside Asia. The Chinese investors outbid their peers because they have a longer-term perspective and value the intangibles of the targets as scarcer. Despite the policy makers and the public opinion being increasingly attentive to acquisitions made by state-controlled entities in sensitive industries, the mainstream theories of FDI do not explain its political or strategic implications, which is a significant pitfall.

COFDI shares several features of FDI from other emerging markets. What is unique to COFDI is the competence with which the CCP used the policy levers to improve China's advantages. In China, the distinction between public and private ownership is artificial – SOE and large private firms are both captured by the state, even if through different mechanisms. This thesis synthesized the motivations for COFDI in the EU, explaining that the growth was driven by economic and political factors, whereas the decline was politically driven. The interest in acquiring political influence is just one among several business and political factors.

		Rise until 2017	Decline in 2018-19

Push (From China)	Economic/ Business	• Traditional Dunning's motivations
		  ○ Seek resources, efficiency, markets and strategic assets (tech, know-how brands)
		• *Blurred* because Central planning implies that several firms are SOEs and even private firms are better of aligning with state's guidelines
			• Firm's desire to invest abroad did not decrease, but COFDI controls became tighter
			  ○ More scrutiny to approve/finance COFDI
			  ○ Avoidance of capital movements associated with moving private wealth abroad
			  ○ *Grey Rhinos* were stopped
			• FX reserves dropped from USD 4Tr to 3Tr in 4 years, reducing the need for diversification
			• Certain rhetoric creates uncertainty about the future of the EU-China relations

	Blurred frontier		
	Political	• High volumes of savings (foreign exchange reserves) require (financial) diversification • Interest in acquiring political influence in EU??	
Pull (From EU)	Economic/ Business	• Companies desperate for capital after financial crisis, and limited appetite from other investors • Chinese market important to EU companies	• Less necessity for inward FDI in peripherical countries
	Political	• EC and states focused on FDI attraction to save corporations and public finances • Strategy more focused in opening China to EU companies than to limit EU for COFDI	• Tighter COFDI controls at EU and states' level • Media pressure demonizing Chinese intentions • Active pressure from USA administration • Political nationalism on the rise

This thesis has articulated the summary of the arguments for the West to worry about COFDI.

Economic pitfalls	FDI with less spillovers	• One of the main advantages of FDI relates to the **technological and know-how spillovers** into the local economy as workers and R&D move to the host country • In COFDI, **it is China gathering know-how** (which moves in the opposite direction)	• Frequently valid, but was not the driver of the sale (money was)
	Lower labor and environmental standards	• The risk of **"siphoning off",** which consists of gradually reducing local employment • Fears that under Chinese management the companies have **less respect for labor, safety and environmental standards**	• Not frequent
Geoeconomics	Enable China's economic leadership	• ***The Realist argument*** - acquiring strategic assets enables the reduction of the competitiveness gap, which **facilitates China's rise to economic supremacy** • **Unfairly so**, due to state ownership/financing, concertation and lack of reciprocity	• **Critical argument, particularly from US perspective**
Concedes political leverage	Harder promotion of Western Values in China	• **Economic (inter)dependence reduces EU's appetite for holding its ground** in political or geopolitical disputes (e.g., human rights, Taiwan issue) • "Divide and conquer" and "Trojan worse" tactics may bear fruits	• True, but conscious, and politics is about trade-offs

	Easier promotion of Chinese values in the West	• **China owned companies may serve as agents** by spending "small fortunes" in
		  ○ **lobbying** for favorable foreign policy
		  ○ **PR that limits criticism** towards China and defends the "China model"
			• True, and must be dealt with by local rule of law

Defence and security threats	Allows access to tech with security applicability	• China is not an Ally and there is an Arms Embargo against China in the EU • Nevertheless, **the acquisition of dual usage technology** (civil technology which can be converted for military purposes) **by China is a very sensitive matter**	• True, and needs to be regulated. Red lines are to be respected
	Opens the flank to boycott and sabotage	• China ownership, and particularly **Chinese operational control over sensitive infrastructure** (e.g., energy production and distribution, other utilities) or other critical economic inputs could be **used for boycott or sabotage** in case of conflict	• Speculative, but needs to be regulated and scrutinized

The analysis of the Chinese economic statecraft literature shows that COFDI is an intrinsic part of the Chinese economic model, in which China sterilizes its massive current account surpluses and invests abroad to secure natural resources, new technology, strategic infrastructure, support backbone industry, guarantee demand for its products and apply its savings in a diversified set of debt instruments. The economic influence, political influence, prestige and military power are inextricable consequences of that, and it is not prudent to presume that COFDI is essentially driven by the desire to acquire political influence. On the contrary, the practices of political warfare, which China may be applying with varying intensity levels in different countries, are not dependent on COFDI and should be understood separately.

The ability to control commercial actors is what determines the success of Chinese economic statecraft, and such control is not guaranteed: it depends on the level of *State Unity* and *Goal compatibility*. The *market structure*, the *relative resources* and the *reporting relationship* also play a role. The success of CCP in pushing for the *Going Out* policy is a proof that effective central command is sometimes possible, but success requires a lot of very high-level attention, so that senior leaders can only devote energy to critical initiatives, thus paying little attention to small/midsize COFDI, such as those in Portugal. China may engage in economic statecraft for *bolstering* (fostering economic interaction which makes China's economy stronger) or in search of *strategic transfers* (supporting economic interaction which enhances war-making capabilities through the acquisition of strategic goods, expertise, resources or dual-use, and/or dedicated military technologies).

When attempting to convert economic power into political influence in Europe, China uses three strategies – specific reciprocity, diffuse reciprocity, and strategic engagement – but reciprocity strategies, which aim to leverage short-term opportunities, undermine China's

aspirations to be perceived in the EU as a benevolent partner. For this reason, fears of China's economic coercion should not be overdrawn. Instead, China follows an orchestration approach which integrates three core elements: nesting, lucrative tournaments, and designing economic statecraft initiatives to maximize interest alignment between central leaders' goals and the interests of implementing actors. Strategic engagement organically generates vested interests which will tend to promote diplomatic accommodation within the target state. But there are limits to this: the recent history of Chinese economic statecraft in Europe provides significant evidence that strategic engagement, even without explicit elements of reciprocity expectations, may lead instead to further anxiety and less political affinity.

The Chinese economic statecraft experience in Europe gets a passing grade, with a handful of poster cases such as Croatia, Hungary, Greece, Italy, Belgium, and Portugal. China can maintain a constructive economic statecraft relationship with several EU countries for three main reasons. First, the issues which are close to China's heart are not mission-critical to the EU (the Tibetan separatism, the maritime disputes, the Hong Kong protests and the HR issues), so the inducements that China is willing to offer more than compensate for the incurred costs. Second, Brussels is increasingly detached from more and more peripheral countries (namely in the south and east), which feel compelled to do China's political bidding, in exchange for its inducements. Finally, the geopolitical fact that China is far away.

In 2020, the EU completed two decisive steps regarding COFDI regulation and management: the implementation of an EU-wide FDI screening mechanism, and the agreement in principle for the EU-China CAI. The first maintains the state's sovereignty but incorporates EU feedback. This instrument will be more effective in helping the host, legitimating the blocking of an FDI, than in forcing a country to reject a desired investment. The second was signed in December

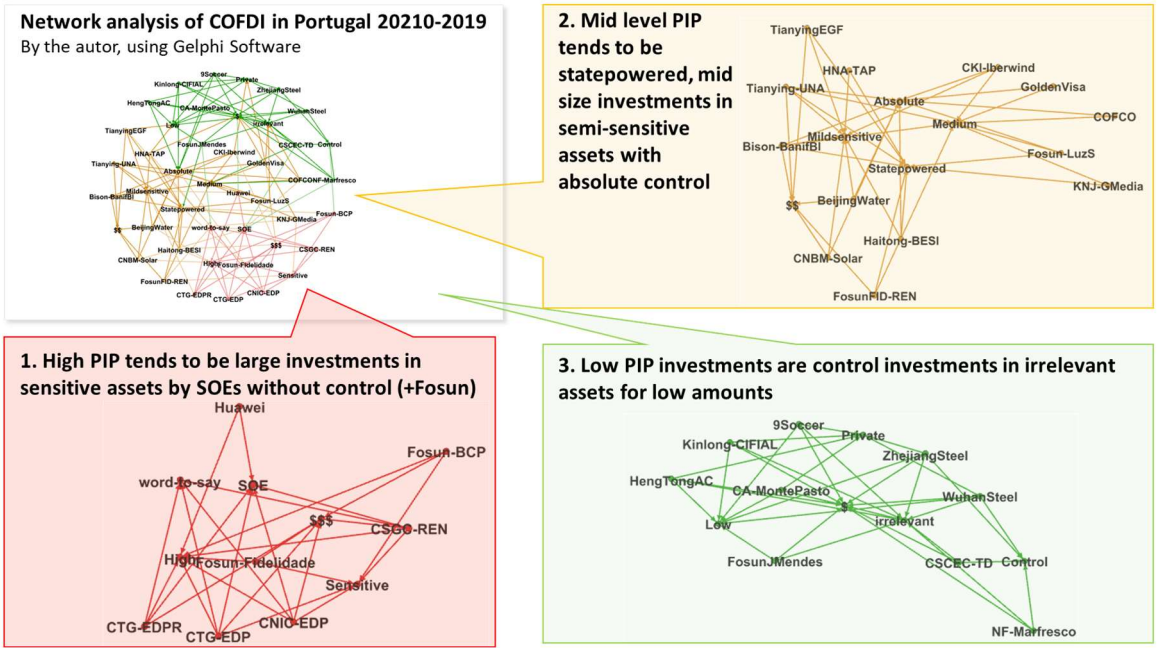
2020. The details of the CAI are not fully finalized but the EU published the Chinese commitments regarding EU's access to the Chinese market and fair competition. The EU seems to have achieved significant concessions: (1) permission for EU FDI in more sectors, (2) a level playing field, (3) China's commitment to several international standards, and (4) typical technical requirements related to arbitrage and settlement of disputes. For China, the objectives were more diplomatic – it maintains the existing openness to CODFI and gets a political victory.

This thesis suggested a methodology to evaluate the PIP of each COFDI case and presented a framework of what else (beyond FDI) should be considered when evaluating the PIP in a country. Increasing the economic interdependence with a target state generates a strategic engagement through which the target state has less incentive to undermine the sender state – it generates a sort of passive (defensive) influence. Nevertheless, it is practically unfeasible to acquire active influence over a target country through economic interdependence alone. And yet, FDI is a logical venue to influence political parties and media groups in a *lawful* manner.

The IFDI stock in Portugal grew from 45 percent of GDP in 2011 to 70 percent in 2019. Of the EUR 50 Bn growth, 25 percent is COFDI. In 2011, Portugal committed to the privatization of several companies (e.g., EDP, REN, ANA, CTT) and the objective to obtain the maximum cash revenues for the state in the short term often prevailed over any other purpose. Despite the unquestionable good intentions, the notion (although hardly avoidable) that too much was privatized is prevalent. COFDI in Portugal between 2011 and 2019 sums EUR 12.3 Bn and is composed of five groups of investments: Energy in Portugal (47 percent), Real Estate (22 percent), Fosun (multiple) investments (20 percent), Haitong acquisition and further capitalization of BESI (7 percent) and all others (4 percent). The years of 2011 and 2014 concentrate each 22 percent of the total investment in the period, driven by the privatizations

of EDP and Caixa Seguros. 2015 saw the third largest COFDI flow due to the acquisition of Iberwind by the largest HK investment group, CKI, and the acquisition of BESI by Haitong. The "others" (4 percent) group includes a broad set of investments across all sectors.

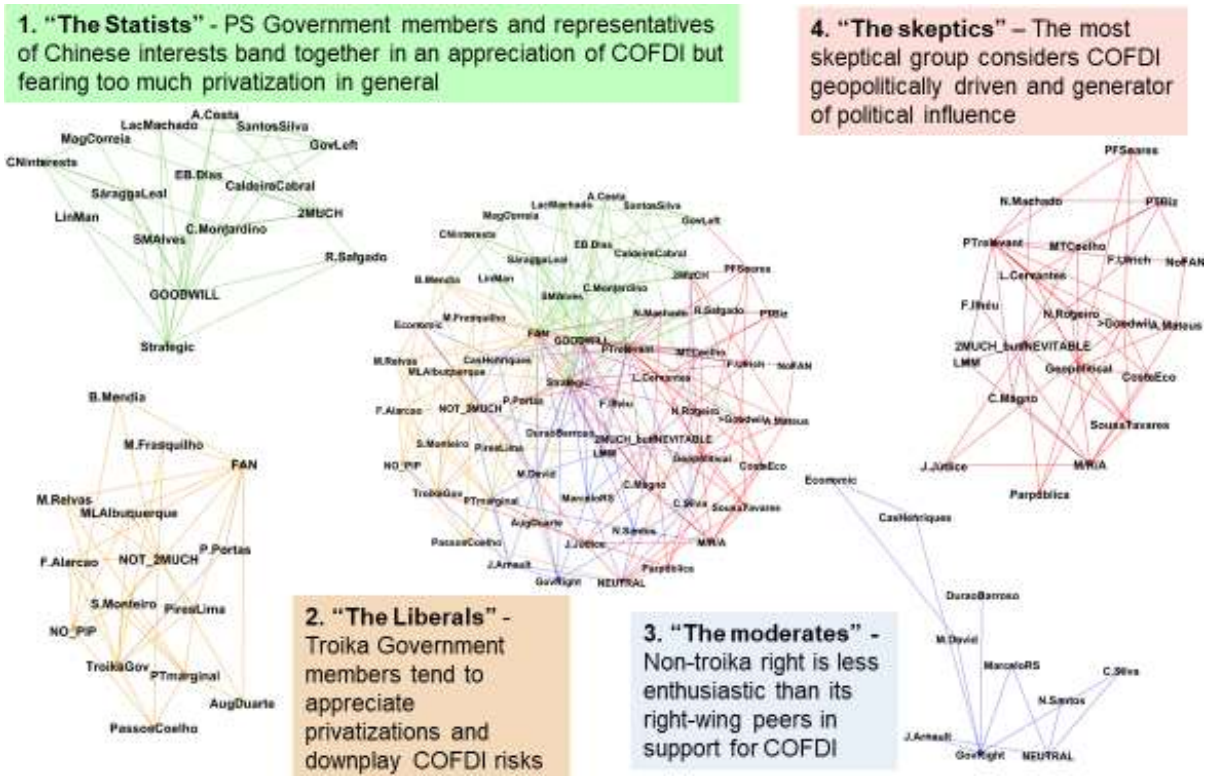
Applying network analysis to the Portuguese COFDI cases identifies three clusters which describe the typical features of investments with high, medium and low PIP.



The behavior of the *control* variable is interesting – very large investments in sensitive assets are either made without control or by state-powered firms which conceal their "publicness". Because the level of control and the level of relationship with the state is not clear cut, the regulators must pay attention to these investments and investigate these attributes. This thesis has confirmed that COFDI is not solely a story of state-owned, fully controlled stakes in sensitive assets: ~33 percent are SOE investments in sensitive assets without control and 31 percent are private investments in non-sensitive assets. Access to know-how and new markets is the main rationale behind Chinese SOE willing to invest without control but such factors are not a main driver to the majority of the COFDI stock. The Portuguese Government played a prominent (touting) role in 56 percent of the COFDI volume and COFDI in Portugal has not

only been about buying and holding mature assets, because COFDI helped push several businesses forward. COFDI has performed reasonably well (91 percent of its volume did).

The perceptions of key Portuguese stakeholders about COFDI are skewed towards appreciation for COFDI, even if many would prefer it in less sensitive sectors, without controlling stakes, and in proportionate size to FDI from other origins. In other words, the national consensus is that if properly managed, COFDI is valuable for the country – it should be steered and scrutinized, but not mitigated or banned altogether. The network analysis surfaces four clearly identified clusters of respondents.



"The Statists" are mostly Socialist party individuals and representatives of Chinese interests in Portugal who appreciate COFDI but because they dislike the privatization of strategic assets, they would rather not have FDI in those fields. They believe that COFDI has strategic motivations (not geopolitical), and its PIP is mostly goodwill. "The Liberals" are elements of the right-wing Government (Troika period) who see limited risk in COFDI. They do not believe

that too much was privatized, nor that COFDI is a source of political influence, and they see Portugal as irrelevant to China. “The Skeptics” tend to consider COFDI as geopolitically driven and a source of political leverage which goes beyond *goodwill*. This does not mean that they oppose COFDI in Portugal. Despite the risks of COFDI, some believe that it can be used as a “small threat card” in dealing with the EU and the USA. Half of them believe that Portugal privatized too much but that was inevitable at the time. “The Moderates” tend of be right-wing, with an interested yet moderate perception about COFDI. None of them opposes COFDI but neither believes that COFDI is only economically motivated or politically irrelevant. Less than 50 percent appreciated the degree of privatization that took place.

The appreciation for COFDI exists, despite the inherent strategic or political benefits obtained by China (70 percent of those supportive of COFDI do not believe that it is purely economic driven). There is a consensus in Portugal about the importance of COFDI when it arrived. Beyond that, some interviewees value more the exporting potential and others value more the *threat card* that China can play in the relationship between Portugal, Brussels, and the USA. But everyone recognizes that China is one of the most important political powers and it would be illogical to waste the advantage that comes from the long-lasting relationship created via Macau. China is also important to the EU for both economic and political reasons and the EU needs to be wise in managing this relationship acknowledging its security alliance with the USA, but also aware of the differences between the American and the European interests.

Most stakeholders believe that Portugal is more relevant to China than what its economic size could indicate. This is partly explained by Portugal’s role in the EU and in the CPLP, as well as the good historic relationship. But the openness that Portugal showed to COFDI in its strategic assets brought the bilateral relationship to a whole new level. There is no consensus

about what role the USA should play in Portugal's management of COFDI, nor the impact that COFDI can have in the transatlantic relationship. Several respondents stress that not even the USA opposed COFDI when it arrived. The official line is that China and Portugal are partners but not allies. They cooperate in diplomatic, educational, cultural, and economic terms, but do not cooperate bilaterally in matters of defence and security and are not aligned geopolitically.

The perceptions about COFDI motivations are categorized by this thesis in three levels. *Economic only*; *Economic/Strategic* (when China is also presumed to be using Portugal as a platform to access other geographies or important know-how, otherwise unavailable); and *Geopolitical* (if COFDI were driven by the pursuit of political influence or other geopolitical objectives). Few respondents believe in *economic-only* motives. The *Economic/Strategic* qualification is prevalent, and the rationale for COFDI is always access to technological know-how or new markets. There are several respondents who see *geopolitical* motivations and half of them are against COFDI or neutral. Their main concern is Chinese State ownership.

About the hypothetical political implications, the prevailing perception is that COFDI provides China with a mild form of political influence called goodwill. Most of the respondents related to the right-wing Government during Troika believe that COFDI is overrated, because it does not necessarily provide China with any material political leverage. Nevertheless, a quarter of the stakeholders believes that China already holds relevant political influence which goes beyond goodwill, and is operationalized via active interest groups formed by influential individuals who are economically incentivized to defend China's interests. China may not have active influence over the political regime but is very much interested in avoiding criticism in the media. The power in Portugal is fragmented, and no one can have dominant power. But veto power is possible, and the Chinese already have it to some degree. Off the record, many

respondents name concrete PR/lobbying agencies which are hired by Chinese interests to actively engage the media in promoting pro-China coverage and limiting the anti-China articles. At the same time, no one perceives this as a threat to the national sovereignty.

It is consensual that privatizations were necessary at the time of the Troika intervention, and everyone is aware that the Chinese were more capitalized and interested in the program than other countries. That made it natural – not inappropriate – that China acquired a lion's share. But some specific cases enjoy limited support because they are harder to execute and regulate and the national interests may be in jeopardy. The main concern focuses on having REN and EDP in the hands of the Chinese state. Even members of the Troika Government doubt the merits of that decision. These results are surprising to the author of this thesis because they miss a critical point: the trickiest cases to deal with are the Fosun's investments because Fosun is an important grey rhino and needs to be monitored very closely. Illustratively, Fosun acquired Caixa Seguros (Fidelidade) for EUR 1 Bn and currently has EUR 2.5 Bn of its assets loaned to Fosun companies, which is clearly unacceptable and grossly overlooked. Independently from the respondents' agreement to the level of privatizations, everyone demands good regulation of critical sectors. Most respondents want restrictions to FDI in strategic assets, irrespective of its origin. The discrimination against non-EU investors reduces the pool of bidders, thus reducing the assets' valuations. Many stakeholders worry about the country's ability to regulate sensitive sectors, because although theoretically possible, the nomination logic and the low compensations impede the necessary competence and independence.

The respondents tend to agree with a hypothetical Chinese presence in the Sines Port, provided that a bullet proof contract is in place to protect the national interests. At the same time, a Chinese presence in Lages is almost universally opposed by the respondents.

8. 2 Implications moving forward

8.2.a. Implications for Portugal

Provided that Portugal remains a secure and safe place, its population's main concern is the poor economic performance which has ensued since joining the EMU. The average salary is ~1,300 EUR/month and 20 percent of the active population earns 60% of that. Portugal's main economic challenge is poor labor productivity, which is explained by its main bottleneck, the lack of capital (domestic or foreign). As such, Portugal just cannot afford to waste China's willingness to invest in the country and to use that as leverage to attract FDI from other origins. The country's prevailing stance regarding COFDI, and rightly so, is to *have the cake and eat it too*. This means using COFDI as a proxy for domestic capital, balancing it against the dependence from Western powers and pulling all parties to invest further, with due wariness about tangible security threats.

First, in welcoming COFDI, Portugal cannot do so with ostensible disregard for the USA concerns, which require careful and active diplomatic management. There is no EU army and Portugal's security depends on NATO (i.e., the USA).

Second, Portugal needs to improve its regulatory competence in all sectors where Chinese State ownership, if ill-intended, could cause harm. That includes sensitive sectors and strategic assets, but also any controlling stakes in sizeable assets. State-powered groups such as Fosun and other *grey rhinos* require stricter oversight. The lack of scrutiny over how much of Fidelidade's assets are concentrated in Fosun debt (EUR 2.5 Bn in 2021) is not acceptable.

Third, China-controlled companies can hypothetically influence the media, political parties, universities, and other institutions since they can legally hold these institutions hostage of their financial inducements. The check and balances must monitor political warfare practices.

Finally, Portugal should maintain an up-to-date analysis of PIP of all its COFDI cases.

8.2.b. Implications for the EU

Regarding China, the EU has a serious problem of interests' misalignment. The member states have different priorities (reasonably organized by sub-region), and its interests are misaligned with those of the USA, which is its major security ally but has behaved too volatile and self-centered to be considered a fully reliable partner. So, the implications must be presented conditionally.

If the EU does not want to further alienate its *Southern* and *Eastern* members it must accommodate their desire to have more COFDI in parallel to defending the *center*'s interest in trade and investment reciprocity and level playing field. At the same time, it should not be naive regarding its ability to influence China's HR perspective and domestic political regime.

Keeping all EU member states engaged with the EU project requires much better management of the centripetal forces of its single market, meaning that the structural funds being sent to the periphery must be invested in sectors which increase those countries competitiveness in tradable sectors. Allowing it to be consumed out or invested in non-tradable sectors is unsustainable.

If the EU wants to pursue a middle-ground strategic positioning as a third pole between the USA and China, it will have to invest significant resources to build its own security capabilities (including a fully capable army of its own). But since that takes a long time (more than a decade) the middle ground positioning requires careful diplomatic transatlantic management.

On more tactical grounds, the EU could have an EU-level observatory of political warfare practices happening in its member states. Moreover, the EU could maintain a tight oversight of all COFDI cases that may leak defense or dual usage technology to China. Likewise, it could consider maintaining an up-to-date analysis of PIP of all COFDI cases in its member states, which incorporate a closer eye on grey rhinos, not just SOE investments.

8.2.c. Implications for China

Provided that China remains economically endowed to continue engaging in economic statecraft in the EU, it has good chances of succeeding avoiding an EU cohesive opposition to its continued rise. For that to happen, it needs to continue calibrating its economic statecraft playbook, incorporating the learnings along the way.

One of the important learnings from this thesis is that the monitoring of political warfare practices is growing exponentially. Therefore, China should be extremely careful and avoid being caught by the watchdogs under any circumstance. At the same time, it is reasonable that China uses softer power techniques to continue improving its image in the EU.

Another important learning is that China will need to continue providing strong economic inducements to Germany (the lord of the EU system) plus a handful of states, among which Portugal is a good candidate to be maintained.

In Portugal, China needs to make sure that it is perceived as investing capital in greenfield developments which create jobs, ideally in tradable sectors. Given the specific situation created by the COVID-19 pandemic, perhaps a well thought program to save several hospitality facilities could be catchy.

It is very important that China manages the fall of the grey rhinos carefully. Illustratively, since Fidelidade is by far the largest insurance company in Portugal and it owns EUR 2.5 Bn of Fosun Group's debt, it would be catastrophic for Portugal if Fosun defaulted on such debt. Such scenario would be a decisive blow to China's image in the country.

Finally, if China wants to maintain a handful of closer friends in the EU it will probably need to understand that they do their bidding on the backstage while attempting to keep a good balance in their relationship with Washington and Brussels. There will probably be less space for ostensible China support in the 2020s then what existed in the 2010s.

9. Limitations and suggestions for future research

Independently from China, it has been mentioned, time and again, that the existing FDI theories do not take proper account of state-sponsored FDI and how state ownership impacts the political and strategic implications of FDI. The COFDI scholars provide some food for thought to that, but such developments need to be done at a broader, non-country specific level.

Additionally, FDI studies suffer from the lack of accurate information about bilateral FDI flows. The main problem resides in poor tracking of the ultimate beneficial owner and its origin. The EU has already developed a firm-level database using Bureau Van Dijk's information called FOWN, but unfortunately its managers did not accept to share it in the context of this thesis.

The existing reports about Chinese political warfare still present underwhelming evidence and too strong a rhetoric. If their allegations are legitimate, it would be very important to share more information about what is known and in a less propagandistic tone. That would probably enable similar investigations to happen in Portugal, where none has been performed.

Other scholars could take the individual investments' PIP methodology proposed in this thesis to the next level by applying it to other countries (and to Portugal) on a continuous basis, to allow for country-to-country comparison and time-series analysis. The algorithm itself could be improved, by applying other weighting methods or even by incorporating other variables.

It would also be interesting if someone would create a PIP indicator for the accumulated stock of FDI in a country, or even for the whole economic statecraft endowment. This would be useful to do for COFDI but also for other FDI origins to also allow for country-to-country comparison and time-series analysis. Similarly, such extension could be done to the usage of network analysis in evaluating the perceptions of key stakeholders about COFDI in multiple countries.

Hopefully, other scholars will dispute this thesis' view on the specific COFDI case studies or even on the stakeholders invited for the analysis. That would be an honor, since that is precisely what scientific production is all about.

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Environment

CTG - EDP

	China Three Gorges (CTG)	EDP
History of the company	• Set up by the Chinese Government in 1993 to oversee the construction and management of the Three Gorges dam, which was the largest in the world • Since 2012, develops new projects in China and overseas	• Created in 1976, as a Portuguese public company, by concentrating all 12 regional Portuguese electricity companies; Gradually re-privatized until 2013 • Largest Portuguese company with about 12K employees
Business activities	• Production of hydro (25.4 GW) and wind (0.2 GW) power in 2010 • Did not have know-how in non-hydro and was interested in (1) renewable energy know-how, and (2) international expansion to the EU and Latam • Also interested in gaining business acumen ("was a company of engineers")	• Production, distribution and commercialization of electricity (traditional and renewable sources), and commercialization of gas • 23.2 GW of installed capacity in 2011; Large renewable player globally (through EDPR, which is 82% owned by EDP)
Geographical footprint	• China only (prior to the transaction)	• Portugal, Spain, USA, Brazil, Italy, Poland, France, Belgium, UK, Canada and Romania
(Prior) **Financial performance**	• €2.5 Bn EBITDA • €1.2 Bn Net income • € 0.7 Bn Net Debt	• Stable economic performance but deteriorating financial position
Ownership and decision makers	• 100% State-owned, via SASAC - the public holding of top SOEs • Cao Guangjing was the Chairman, but in 2014, after some corruption charges, he left to become Vice-Governor of Hubei Province	• Parpública (26%), Iberdrola (7%), Liberbank (5%), José de Mello (5%), Senfora (4%), BCP (3.4%), Sonatrach, BES, Norges Bank, ~40% floating • Dr. António Mexia, CEO throughout the whole period was the decision maker; Dr. João Manso Neto, CEO of EDPR, was also very powerful
Recent events	• CTG was a relevant hydro producer, but its image was poor and associated with environmental (pollution & geologic) problems in its dams	• In February 2012, Standard & Poor's reduces EDP rating to BB+ with negative outlook and Moody's reduces rating to Ba1 with negative outlook
Ties with other COFDI cases	• The CTG investment in EDP is tied to the CSGC presence in REN. First, because both are SOEs and a controlling stake in either of the two would require divestment from the other: only minority stakes can coexist despite the company's management teams not getting along. Second, REN is a critical transmission provider to EDP • This is part of a set of 3 investments: CTG in EDP and two "adjacent investments" CTG in EDPR and CNIC in EDP	

EUR Bn	2008	2009	2010	2011
Revenues	13,9	12,2	14,2	15,1
Net Profit	1,1	1	1,1	1,1
Operational Investment	3,6	3,2	2,7	2,2
Net debt	13,9	14	16,2	16,9
Market capitalization	9,9	11,4	9,1	8,7

Sources: Interviews to Dr. António Mexia (CEO of EDP), Dr. Martins da Costa (Board Member EDP), Dr. Luís Amado (President of General and Supervision Council of EDP), annual report of EDP 2011 and 23.12.2011 Strategic partnership doc. of EDP & CTG

Strategy

CTG - EDP

Acquisition process (including Portugal State involvement)	• In 2012, Parpública organized a public competitive tender and the final three bidders included also E.ON (Germany) and Eletrobras (Brazil) • Multiple sources recall that the Portuguese government started looking for Chinese investors before Troika (2010) – for example through Dr. João Marques da Cruz, who was Board member at CEM – the electrical company of Macau; CTG considered to invest in CEM even before investing in EDP • Some members of the government suggested a "geopolitical" preference for the other bidders, but the Council of Ministers decided against such criteria • Since all bids followed due process and presented reasonable strategic plans, CTG won based on its best price (CTG = €2.69Bn; Eletrobras = €2.56Bn; E.ON = €2.54Bn)
Deal terms and governance model	• €2.69bn for 21.35% equity stake in EDP, i.e., €3.45 /share – implies a premium of 53,6%; Paid amount was deducted of dividends from 2011 received by Parpública • The deal package also included (1) CTG to invest €2bn in 34-49% equity stakes in operational and ready-to-build projects in Portugal or abroad, representing 1.5 GW (net), in first three years and (2) committed credit facility of up to €2bn provided by a Chinese financial institution to EDP at corporate level with 20 years maturity • CTG representation at the General and Supervision Council with 4 members (out of 23); no control over the management; No access to non-public info about USA ops
Business plan and synergy expectations	• On the one hand, EDP's strategic pillars of low risk (e.g., proactive regulatory management) and stable cashflow (high pay-out ratio) remained in place • On the other hand, it was signed a Strategic partnership with CTG, which would inject additional €4bn (as explained above) to leverage the Portuguese know-how and market access: The target volume of new projects was 600 – 800 MW in Europe; 600 – 800 MW in US; 0 – 200 MW in South America
Financing mechanism	• Chinese initial capital injection and future capital commitments are financed by the cashflow of the Chinese operations (CTG dam) • Credit facility provided by CBD, one of the most important development banks in China, which opened a branch in Portugal • Until 2019 the Chinese Sovereign Fund CNIC also accumulated ~5% of EDP (stock market); CTG itself invested additional EUR 208Mn in stock purchases in 2017
Seller motivations	• Portuguese government needed to sell assets (including participations in private companies) to generate proceeds to amortize the public debt (under Troika program) • EDP was reducing its investment in new assets due to lack of financial resources, which was perceived as a wasted opportunity given the know-how within the organization and the established positions in the Americas and Europe • The rating agencies were downgrading their assessments (as mentioned before)
Buyer motivations	• CTG developed the CTG dam in a project of ~€24 Bn Capex which relocated 1.2m people. This social cost, together with several other pollution and technical concerns fostered the desire to achieve a better public image: international expansion with focus on renewable energy was considered a good venue • The proceeds from the 22.5 GW project represented a massive liquidity flow which could be used to invest in acquiring new projects and know-how • CTG acquired a minority stake at EDP, a well-established company with presence in North America, Europe and other geographies but also with significant know-how in activities beyond hydro production - It is important to understand that CTG was a team of engineers with limited business experience abroad • EDP strategy was maintaining strong cash generation in existing assets and generating new opportunities for massive investment abroad; In these opportunities, CTG could gain technical and business know how, but also co-invest with EDP until it would also start investing directly, on its own, as it did later in Peru (€3.2Bn) • From the Chinese side, this deal was perceived from the beginning as a state-to-state transaction and the endorsement by the Portuguese government was valued

Sources: Interviews to Dr. António Mexia (CEO of EDP), Dr. Martins da Costa (Board Member EDP), Dr. Luís Amado (President of General and Supervision Council of EDP) and Dr. Pedro Passos Coelho (PM of Portugal at the time); annual report of EDP 2011 and 23.12.2011 Strategic partnership doc. of EDP & CTG

Performance

CTG - EDP

(Post deal) **Financial performance and future prospects**	• Recent financial performance is not optimal: Net profit decreased from €1.1bn prior to the investment to €0.5bn in 2018 (see table on the right). In 2017 there is a €+268Mn one-off effect associated with portfolio reshuffling in Iberia, and in 2018 there was a €-277Mn one-off effect from regulatory; Adjusted net profit is currently about ~€0.8bn per year • The worsening of the financial performance is directly linked to regulatory changes which are not well regard by CTG • Until 2019, CTG earned €1.05bn in dividends and invested ~ €1.7bn in renewable projects (target is €2bn)
Evolution and effectiveness of Chinese control	• As mentioned, CTG is represented at the Supervisory Board, but without control over the management; The statutes of EDP determine that no shareholder can have more than 25% of voting rights; American intelligence verifies that no non-public info about the US ops is shared with CTG representatives • EDP's strategy was to strengthen position in advanced markets and generate returns to investors, whereas CTG privileged scale KPIs ("stronger, bigger, more MWs") • By 2018, CTG decided that its minority position without control did not suit its interests and launched a takeover bid for a majority stake, which required approval from the US and PT governments, and the EU. It would also require a change to the statutes of the company, dropping the 25% limit of voting rights • According to EU regulation, CTG owning a majority stake in EDP implied that CSGC would have to leave REN; The Portuguese government did not oppose the bid • The USA government followed the process at the highest level (because EDPR is the 3rd largest player in the USA) and voiced explicit scepticism (to say the least) • The bid was refused by the shareholders - It was regarded as a failure in China and exposed the fragility of CTG's position in EDP; CTG managers were displaced • EDP landed in a awkward equilibrium where the Chinese presence cannot grow but also avoids EDP being a target of hostile takeovers in the market
Evidence of synergies between investor and target	• The value added from CTG to EDP is mostly visible at the liquidity and solvency levels. On the other direction, it is clear that CTG profited from EDP's credibility and market access. After investing in EDP, CTG was able to grow outside Portugal as described below; CTG brought thousands of cadres to Portugal for training • CTG was disappointed to understand that its state-to-state relationship did not protect EDP from regulatory changes (with tangible impact on the profitability)
Relevance and potential for political influence	• EDP is the largest Portuguese company and the ability to hire former politicians to its Boards is one of the possible ways to leverage such a relevant asset • At the same time, it became clear throughout time (including during the failed takeover process) that CTG does not control the management of EDP and therefore cannot steer the power of the company according to its own interests. Much less so to interfere in its daily operations • It also became clear that CTG's presence in EDP does not provide regulatory protection
Concertation with other Chinese companies in PT	• CSGC owns 25% of REN (national transmission grid). The control of CSGC over REN is not absolute, but it is perceived as higher than that of CTG over EDP • While there is significant speculation about the proximity between CSGC and EDP because both are owned by the Chinese state, the truth is that the relationship between the two is cold. CSGC officials always regarded the CTG position in EDP as threatening to its position in REN because a controlling stake of CTG in EDP would require CSGC to leave REN (for competition reasons); During the takeover process the leaders of CSGC escalated their opposition to the bid to the Politburo • REN recommended to the National Grid Plan that an off-shore line dedicated to an EDP wind park was prioritized – this was highly criticized by the public
Ability to grow outside Portugal	• CTG was able to partner with EDPR in France and the UK, and was capable of acquiring positions in Brazil (€3.4bn for 2 hydro projects Ilha Solteira and Jupia) and in Germany (80% of Meerwind 288Mw wind Farms); In 2012 CTG invested €208mn to acquire 1.92% in EDP and, in 2017 €248mn for 49% of ENEOP from EDPR

EUR Bn	2016	2017	2018
Net Profit	0,9	1,1	0,5
Net debt	15,9	13,9	13,5

Sources: Interviews to Dr. António Mexia (CEO of EDP), Dr. Martins da Costa (Board Member EDP), Dr. Luís Amado (President of General and Supervision Council of EDP) and Dr. António Costa (PM of Portugal); Annual reports of EDP 2017-2018

Corroboration of key propositions and calculation of PIP indicator

CTG - EDP

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	4	8	9.5	• Energy production and particularly distribution is considered strategic by the majority of the FDI regulatory bodies; EDP has a dominant position in Portugal
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• The buyer is a SOE directly owned by SASAC and the credit facility was provided by CDB, one of the most important public banks in China
	3. Require controlling stakes and ability to steer the companies' decisions	1			• The Chinese investor clearly does not control, not even minority control, over the management of the company; Uncomfortable situations have happened
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3			• The purchase of equity from the Portuguese government was already EUR 2.7Bn, well above the EUR 360Mn threshold for being considered very large
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• Multiple sources confirm active involvement of the government in searching for Chinese investors, even before Troika; E.g., via Dr. João Marques da Cruz
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1.5			• The relationship between CTG and CSGC is tense because a controlling stake in one require the divestment of the other; But REN's recommendation for the public payment of EDP's offshore connection raised suspicion of concertation
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2/3 Invest in growth			• The €2.7 Bn to acquire 21.35% were cashed out by the state but the additional €2Bn were agreed to be deployed in 34-49% of new ready to build assets
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	4/4 Important entry door			• CTG regarded EDP as a entry door to several geographies, not only EU but also North and South America
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	4/4 top priority			• EDP has deep know how in distribution and multiple production methods, whereas CTG was focused on Hydro and modest Wind production experience
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Until 2019, CTG earned €1.05bn in dividends, which about 5%/year, but the net profit has reduced more than 30% in the meantime

2 investments adjacent to CTG – EDP investment

CTG - EDP

	CTG investment in EDPR	CNIC investment in EDP

Who	• As of April 2021,
	  • EDPR, which is the renewables subsidiary of EDP, is 82% owned by EDP
	  • EDPR market cap is EUR 16Bn, whereas EDP market cap is EUR 20Bn
		• CNIC is a Hong Kong-registered business majority owned by SAFE, the central regulator responsible for managing China's foreign reserves

Deal	• CTG has acquired from EDPR EUR 700Mn minority equity stakes in Portuguese renewables projects summing (projects abroad excluded):
	  • EUR 359Mn in 2012
	  • EUR 94Mn in 2014
	  • EUR 248Mn in 2017
	• This transactions are part of the overall deal of CTG entering EDP
		• CNIC has acquired 5% of EDP in 2018 for EUR 660Mn
		• This transaction must be understood as a reinforcement of the Chinese State's participation in EDP in the context of the attempt to gain control over it

Features relevant for PIP	• For PIP purposes these transaction are considered an additional single transaction with the following attributes:
	  • Sensitiveness: Mild sensitive (2)
	  • Government ownership: SOE (4)
	  • Level of Control: Word-to-say (1)
	  • Deal size: Large amount (3)
	  • Government touting: Yes (2)
	  • Concertation with other COFDI: Potential conflict (1.5)
		• For PIP purposes this transaction has the following attributes:
		  • Sensitiveness: Sensitive (4)
		  • Government ownership: SOE (4)
		  • Level of Control: Word-to-say (1)
		  • Deal size: Large amount (3)
		  • Government touting: Yes (1)
		  • Concertation with other COFDI: Potential conflict (1.5)

PIP	• Therefore, the estimated PIP is:
	  • Version 1 : 6
	  • Version 2: 7.5
		• Therefore, the estimated PIP is:
		  • Version 1 : 8
		  • Version 2: 8.5

Sources: EDP and EDPR annual reports; Financial times (https://www.ft.com/content/72bcb14a-73db-11e8-aa31-31da4279a601);

Environment

CSGC - REN

	China State Grid Corporation (CSGC)	REN
History of the company	• Created in 2002 (Beijing), largest utility globally - 7th in Fortune 500 • China's largest electricity transmission & distribution operator • Covers 88% of China and serves 1bn consumers • About 2 million employees	• Created in 1994 as a spinoff of EDP – controlled by the Portuguese government to manage electricity transmission (TSO) in Portugal • In 2006, acquired gas TSO business from Galp with 40 years concession • ~730 employees
Business activities	• Electricity transmission & distribution	• Electricity and gas transmission (TSO) in Portugal • Minor presence in operation of telecom emergency network
Geographical footprint	• China, Brazil (3.000Kms of transmission) and Philippines (owns 40% of National Grid – 19.000 Ks of transmission)	• Only Portugal at the time of transaction *(Now is also present in Chile)*
(Prior) **Financial performance**	• Revenues of €186Bn in 2010 • Total Assets of €267Bn in 2010 • Net income of €4Bn in 2010	• Steady reduction of market capitalization despite good performance of EBITDA (grew 10% from 2010 to 2011)
Ownership and decision makers	• 100% SOE, via SASAC • President Liu Zhenya	• Portuguese government used to have majority control over the company and Rui Cartaxo (former CEO) was well aligned with Parpública (Public holding) • New CEO (Rodrigo Costa) was able to maintain a strong position, provided that he respects the interests of the Chinese investors (both CSGC and Fosun)
Recent events	• Acquiring a lion's share in the global market of electricity transmission and distribution is a priority for the Chinese government which strongly endorses CSGC's going global policy	• The sale of 40% of REN was a compulsory component of the €78Bn financial rescue package under the Troika program in Portugal • REN was gradually reducing its investments in the Portuguese electricity network, which is old and has some important bottlenecks (e.g., southwest)
Ties with other COFDI cases	• This investment increased the business activity between REN and other targets of COFDI: namely Alcobre (cables) and Fidelidade (insurance); • Tied to the CTG/EDP investment because the Chinese state is not allowed to have effective control on EDP and REN simultaneously • This investment has an adjacent investment which is Fosun's 5% participation of REN via Fidelidade	

EUR Bn	2009	2010	2011
EBITDA	384	431	472,5
Net Profit	134	110	121
Operational Investment	466	443	349
Net debt	2,1	2,1	2,3
Market capitalization	1,6	1,4	1,1

Sources: Interviews to REN, Fosun and CSG employees; Annual reports of REN and Parpública

Strategy

CSGC - REN

Acquisition process (including Portugal State involvement)	• The Government decided to make a two-phase process:
	  • The first phase was a competitive bid for a *direct sale* of 40% (with a limit of 25% for each bidder)
	  • The second phase was the alienation of 11% through an *accelerated book building* method
	• Price achieved was considered above market (by the public auditor), therefore the auditing of the process considered it adequate

Deal terms and governance model	• In 2012, the 40% stake was sold for €592Mn, of which 25% were purchased by CSG for €387m (first bidder) • The deal package included a €1Bn credit facility to be provided by CBD (one of the largest development banks in China) • Agreement for REN to become a provider of CSGC in Brazil and to create JV partnerships in Angola and Mozambique • Important to notice that in the 2nd phase of the privatization (2014) Fosun, a Chinese private company, purchased 3.9% of REN for 56Mn • Other large investors (above 5%) include Gestmin, Logoplaste, REE (Spanish Grid) and Oliren
Business plan and synergy expectations	• As one of the largest energy companies worldwide CSGC had significant value-add to offer to REN • The most important expectations regarding synergies were associated with (1) access to financing, (2) cheaper insurance, (3) cheaper equipment and (4) commercial opportunities (e.g., in Brazil) • REN's expected value-add to CSGC was linked to market access in CPLP and at the Portugal-Morocco submarine connections
Financing mechanism	• As one of the largest Chinese SOEs, CSG has easy access to credit facilities with Chinese Banks • CDB offered 1Bn immediate financing as part of the deal
Seller motivations	• The sale of 40% of REN was a compulsory component of the €78Bn financial rescue package • The Portuguese government believed that despite energy transmission being a critical infrastructure, it can be private and closely managed via a concession agreement; the current government is less adept of having the national grid in foreign state hands
Buyer motivations	• The acquisition of REN was regarded as a small investment to CSGC but one where CSGC could add a lot of value • Among the main advantages, SCGC saw (1) high expected financial returns, (2) the stability of the cash flow, (3) the opportunity to grow further in Europe, (4) a good platform to deploy an R&D center in Europe, and the (5) opportunity to add value

Sources: Interviews to REN and CSGC employees; Interviews to Secretary of State Eurico Brilhante Dias and former Prime Minister Pedro Passos Coelho; Annual reports of REN and Parpública

Performance

CSGC - REN

EUR Bn	2016	2017	2018
Net Profit	0,1	0,13	0,116
Net debt	2,5	2,8	2,7

(Post deal) **Financial performance and future prospects**	• CSGC is very happy with the financial performance, which has been stable and aligned with the expectations (stability of EBITDA has been achieved via inorganic growth) • Inorganic growth only in Portugal (TSO business from EDP – EDPG) and Chile (gas and electricity TSO) • Dividend distribution remained high (EUR 90-110Mn/year), yielding 6-8% every year
Evolution and effectiveness of Chinese control	• Despite owning only 25% of REN, CSG feels very respected in REN • The relationship with the CEO is good and the two Chinese representatives (the CTO and the Party representative stationed at the business development department) navigate the company with ease; There is limited intervention and no control over operations • The CSGC investment in REN is generally regarded as one of the most successful and fluid COFDI cases in Portugal
Evidence of synergies between investor & target	• Significant value was added from the investor: (1) access to financing resulting in much lower financing costs, (2) cheaper insurance (changed re-insurance from Switzerland to China) , (3) cheaper equipment (e.g., Alcobre /Hengtong cables, transformers, etc) and (4) commercial opportunities (e.g., in Brazil) • REN's value added to CSGC is not obvious on the technical side but was instrumental in launching *R&D nester* a major R&D center in Europe, which is supposedly independent but clearly controlled by CSGC
Relevance and potential for political influence	• The electric and gas transmission grid is effectively a very sensitive asset • Even though there is a concession agreement and the government can impose the construction of new lines, there is significant room for "feet-dragging" which can have negative effects to the country's network on the medium term • There is objectively no way for a minority shareholder to boycott the operations of the company on a short term perspective
Concertation with other Chinese companies in PT	• REN started working with Alcobre (fiber cables company based in Portugal) only after it was acquired by Hengtong (Chinese company, large global group in fiber optic & electric network); • CSGC was already investigating the REN opportunity when it learned that CTG was likely to enter EDP; ever since the relationship with CTG has been purely institutional without concertation; the off-shore line episode raised eyebrows (see CTG/EDP case)
Ability to grow outside Portugal	• International expansion happened but only in Chile: 2017 acquisition of 42.5% of gas business and 2019 acquisition of electricity TSO; The African play was limited to the acquisition of 7.5% in the Cahora Bassa dam in Mozambique (2012) from Parpública

Sources: Interviews to REN and CSG employees; Annual reports of REN

Corroboration of key propositions and calculation of PIP indicator

CSGC - REN

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	4			• Energy Transmission is considered a strategic asset by the majority of the FDI regulatory bodies; REN operates a monopolistic concession in Portugal
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• The buyer is a SOE directly owned by SASAC and the credit facility was provided by CDB, one of the most important public banks in China
	3. Require controlling stakes and ability to steer the companies' decisions	1	8		• CSGC has some influence over strategic decisions but is far from having operational control and is not able to impact short-term topics
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3		10	• The purchase of equity from the Portuguese government costed EUR 387Mn, above the EUR 360Mn threshold for being considered very large
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• Multiple sources confirm active involvement of the Government in searching for investors to participate in the competitive bidding process
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	2			• CSGC clearly increased business activity of REN with other COFDI targets; Also helped suppliers without local support in PT by reducing that criteria from ~50% to 10% in some categories
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2/3 Invest in growth			• The deal package included growth of the Portuguese grid and the creation of JVs for business development in other Portuguese Speaking countries;
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	2/4 Not a priority			• It can be called a door to the EU because there was no presence in EU before this deal, but there has been no growth in the EU (only Chile)
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	3/4 Just important			• The investor had more knowledge than the target, but this partnership was used for the launch of an important R&D centre called *R&D Nester*
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Good financial performance and dividend distribution (6-8%)

One investments adjacent to CSGC - REN

Fosun/Fidelidade-REN

	Fosun investment in REN via Fidelidade
Who	• The Fosun investment in Fidelidade is one of the case studies presented in this library. The full details about Fosun, Fidelidade and their relationship are presented there
Deal	• As mentioned, the state's remaining 11% in REN were alienated in 2014 in an "accelerated bookbuilding" process. In that process, Fosun/Fidelidade acquired 3.971% and acquired more stock in the stock market over time (total of 5.3% in 2019) • By the end of 2014, Fidelidade already owned 4.94% of REN (4.9% directly and 0.04% via its subsidiaries (Multicare, Via Directa, etc.) • The investment started with EUR 56Mn in 2014 and reached 84 Mn in 2017
Features relevant for PIP	• For PIP purposes these transaction are considered an additional single transaction with the following attributes: •Sensitiveness: Sensitive (4) •Government ownership: Statepowered (2) •Level of Control: Word-to-say (1) •Deal size: Medium amount (2) •Government touting: Yes (2) •Concertation with other COFDI: Potential conflict (2)
PIP	• Therefore, the estimated PIP is: •Version 1 : 5 •Version 2: 7

Environment

CKI - Iberwind

	CKI	Iberwind
History of the company	• Cheung Kong Infrastructure Holdings Limited (CKI) is part of the Cheung Kong Group, the largest infrastructure group in HK • Founded and owned by Li Ka Shing (top 20 richest worldwide)	• Magnum acquired the assets (65% stake) in 2009, from Babcock Wilcox for EUR 1.1Bn • Increased the capacity from 540 MW in 2008 to 726 MW in 2016
Business activities	• Diversified investments in energy infrastructure, transportation infrastructure, water Infrastructure and infrastructure related business; 290K employees	• 726 MW of wind energy in Portugal (2nd largest), in 31 wind parks, with 323 turbines • Cash-cow with fixed tariff
Geographical footprint	• Internationalization started in the 90s after two decades of consolidating the position in Hong Kong • Assets in 50 countries including HK, China, Australia, New Zealand, UK, Canada and continental Europe	• In Portugal
(Prior) **Financial performance**	• EUR ~120Bn market capitalization and consistently able to increase dividend pay-out	• EBITDA of EUR 143Mn in 2014, EUR 136Mn in 2015 and EUR 146Mn in 2016 • Variation directly linked to variability of availability of wind
Ownership and decision makers	• Acquisition by CKI 50% and 50% by Power Assets Holdings Limited (PAH), which is 38% owned and fully controlled by CKI; • Viktor Li, elder son of Li Ka Shing is the key man	• Owned by Magnum Partners, an Iberian private equity group lead by João Talone, Angel Corcostegui e Enrique de Leyva and João Coelho Borges
Recent events	• Consistently acquiring new assets with the proceeds generate from the existing operations	• Nothing relevant
Ties with other COFDI cases	• The HK group does not feel nor wants to present itself as a Chinese Group, in part because it sometimes generates undue defensiveness from the side of foreign FDI and energy regulators; In the case of Portugal there is no interaction with other COFDI	

Sources: Interviews to CKI representative to Iberwind; Iberwind and CKI's annual reports

Strategy

CKI - Iberwind

Acquisition process (including Portugal State involvement)	• Competitive bid, executed in November 2015 • Brookfield Renewable Energy, US private equity firm Cerberus Capital Management, and EFG Hermes of Egypt were also bidding for the wind firm
Deal terms and governance model	• Full control over the Board: Total of 8 members, 6 from CKI and PAH, 1 from the management and 1 independent
Business plan and synergy expectations	• Assets expected to maintain revenues and profits stable
Financing mechanism	• Fully financed by own equity
Seller motivations	• Magnum is a private equity fund with a predefined maturity, which means that after 7 years it needed to alienate the asset
Buyer motivations	• CKI has been actively pursuing cash-cow opportunities to deploy its massive cash holdings • Full control, return on investment and stability of returns are the most important criteria for investment

Sources: Interviews to CKI representative to Iberwind; Iberwind and CKI's annual reports

Performance

CKI - Iberwind

(Post deal) **Financial performance and future prospects**	• Very stable financial performance • Revenues of EUR 176 Mn in 2016 vs. 179Mn in 2018; EBITDA of EUR 145Mn in 2016 vs. EUR 148Mn • CKI was very happy with the regulatory stability in Portugal which contrasts with the experience in Spain (where rules changed to their detriment along the way)
Evolution and effectiveness of Chinese control	• 100% control and fluid experience • CKI has already sold the asset to Ventient in 2020, making very good returns: CKI team could not confirm the exact return but confirmed that the return on equity invested was between 12-14%/year
Evidence of synergies between investor & target	• Very passive experience without negative surprises nor upside to be exploited
Relevance and potential for political influence	• None
Concertation with other Chinese companies in PT	• None
Ability to grow outside Portugal	• Not relevant

Sources: Interviews to CKI representative to Iberwind; Iberwind and CKI's annual reports

Corroboration of key propositions and calculation of PIP indicator

CKI - Iberwind

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	3	6	6	• Renewable energy production is considered a medium strategic asset by the majority of the FDI regulatory bodies
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	1			• Privately owned by Hong Kong national with massive cash holdings and no need for debt leverage
	3. Require controlling stakes and ability to steer the companies' decisions	3			• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3			• Large investment (EUR 1Bn)
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No interaction
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	3 Pure financial			• Pure acquisition of cash-cow without new developments • The investor is actively looking for greenfield opportunities in Portugal
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 irrelevant			• The group is already present in UK, Continental Europe an other Western developed countries
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• IRR above 12%

Environment

Hengtong - Alcobre

	Hengtong	Alcobre
History of the company	• Founded in 1991 by president Cui Genliang, is the 2nd largest cable manufacturer worldwide • Private entity, listed in the Shanghai stock market (since 2003) • 18.000+ employees	• Subsidiary of South African group Aberdare, which invested in Portugal and Spain in the 70s for diversification • Portuguese executive Luís Almeida was CEO at the time of the deal • 80 employees
Business activities	• Provides telecom/energy network products (optical and copper communication, power transmission, marine engineering, etc.) • It is committed to being a relevant provider for 5G networks	• Manufacture electronic and electric wires (low voltage) and cables for household/office facilities
Geographical footprint	• China, Indonesia, Thailand, Philippines, Egypt, Russia, South Africa, Brazil, Spain and Portugal	• Focus on Portugal, with some exports to European and African countries
(Prior) **Financial performance**	• €4Bn turnover (2017) and growing ~40% per year • Net margin of 8%	• Declining revenue (at around ~40Mn) • Inability to invest in working capital to grow the business
Ownership and decision makers	• President Cui Genliang is the key decision maker	• Aberdare, owner of Alcobre, was majority owned by Eletronics corporation limited (Altron) • Luís Almeida, industry executive was the CEO in Alcobre since 2010
Recent events	• Strong positioning within the BRI	• Product portfolio focused on household networks makes the company revenues correlated with real estate development (which was low in Portugal until 2015 and grew strongly thereafter)
Ties with other COFDI cases	• Interesting to assess if the COFDI in EDP and REN resulted in increased sales from Alcobre to EDP and REN	

EUR Mn	2014	2015	2016
Revenue	27	30	23
EBITDA	0,4	0,5	0,6

Sources: Interviews to former CEO of Alcobre Luís Almeida and current CEO of Alcobre Paul Huang; SABI

Strategy

Hengtong - Alcobre

Acquisition process (including Portugal State involvement)	• Hengtong arrived in Portugal as the collateral effect of the acquisition of 75% of a South African company (Aberdare), which owned assets in South Africa, Spain and Portugal (Alcobre) • Spanish operation used to be very large (until it lost the most important customer Telefonica)
Deal terms and governance model	• Majority control • Altron sold Aberdare for R1232 Million (EUR ~77M) in 2015 • Estimated valuation of the Portuguese company of ~€5Mn*; • Capital injection of EUR ~4Mn for facilities and working capital
Business plan and synergy expectations	• Decision of maintaining Portuguese asset was taken without concrete expectation • The main objective was to stabilize the company permitting some growth in the core business • Interesting upside opportunity from using the Portuguese operation to commercialize other products from Hengtong
Financing mechanism	• Access to financing from Chinese (public) banks
Seller motivations	• Lack of resources for growth • Negative outlook for the industry (at least for players without access to fast growing customers such as the Chinese energy and telecommunications operators)
Buyer motivations	• The company was looking for profitable assets outside China and with opportunity to add value • The acquisition of the South African company allowed to enter African markets and Iberia • The case for the Spanish operation was clearer because it included value-add through access to the raw material (fiber) which was a bottleneck in Spain • The rationale for maintaining the Portuguese company (Alcobre) was less obvious but the group decided to "give it a try"

* Author estimates based on market multiples
Sources: Interviews to former CEO of Alcobre Luís Almeida and current CEO of Alcobre Paul Huang;

Performance

Hengtong - Alcobre

(Post deal) **Financial performance and future prospects**	• Interesting ability to grow sales and profits • The Alcobre team was able to gain a contract for Hengtong group (EDP's wind float project in Viana do Castelo - 18.5kms of submarine cable, both equipment and EPC + 10 years maintenance) which resulted in the creation of Hengtong Portugal)
Evolution and effectiveness of Chinese control	• Absolute control over the company • Chinese CEO (Paul Huang), succeeded Portuguese CEO Luís Almeida after two years of overlap
Evidence of synergies between investor & target	• Hengtong investment allowed to expand facilities and machinery • Hengtong network and credibility allowed to become supplier of REN • Presence in Portugal allowed to win the submarine cable tender mentioned above • Spanish operation profited from access to base fiber which was scarce before the deal (and Hengtong provides it)
Relevance and potential for political influence	• Irrelevant
Concertation with other Chinese companies in PT	• Ability to become a relevant provider to REN (contract size is not a game changer to the company) • Also able to generate large sale from Hengtong Group to REN for EDP's in Viana do Castelo project (mentioned above)
Ability to grow outside Portugal	• Not yet, but there are efforts to sell in Germany and Greece

EUR Mn	2016	2017	2018	2019
Revenue	23	37	40	42
EBITDA	0,6	0,6	1,2	1,2

Sources: Interviews to former CEO of Alcobre Luís Almeida and current CEO of Alcobre Paul Huang; SABI database

Corroboration of key propositions and calculation of PIP indicator

Hengtong - Alcobre

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	1			• Portugal does not produce sensitive products, even if the group commercializes cables for sensitive assets, such as fibre backbones and electricity grids
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	1			• Privately help, listed in Shanghai stock market; with access to financing from Chinese banks (also) under BRI but not relevant in this case
	3. Require controlling stakes and ability to steer the companies' decisions	3	2		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	1		3	• Ownership resulted from the acquisition of Aberdere (former owner). Because the group kept the PT operation there was ~8Mn in working capital
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	2			• The group was able to make an important sale to REN in an EDP project
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2 Invest in growth			• Pure acquisition of cash-cow without new developments • The investor is actively looking for greenfield opportunities in Portugal
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 irrelevant			• The opening of the Spanish market was relevant, but it comes from the acquisition of the parent company – Alcobre is irrelevant
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Excellent business turnaround (double sales and EBITDA)

Greenfield investment

CNBM solar greenfield

	China National Building Materials (CNBM)
History of the company	• CNBM is controlled by CNBM Group, a State-owned company owned by SASAC (Chinese Public Holding) • Founded in 1984, CNBM is a publicly traded company, fortune 500, focused on construction materials and EPC • China Triumph International Engineering Company Limited (CTIEC) is CNBM's international EPC division • CNBM has a strategic partnership with UK based WElink Energy (unclear if there are relevant non-Chinese shareholders in WElink)
Business activities	• CNBM is the largest cement and gypsum board producer in China and the largest glass fibre producer in Asia • CNBM owns Jetion Solar, a manufacturer of solar modules • WElink Energy focuses on development of renewable energy projects and housing projects with an energy efficiency link: over EUR 1.2Bn invested in zero carbon housing in the UK, and over 1.1 GW of solar parks developed
Performance	• Big success: projects were license, built and then sold to an insurance company at a large profit
The project	• Development of 46.1 MW solar park (Ourika) in Alentejo Portugal, without subsidized tariff • Followed by the development of 221MW solar park (Solara4) in the same region and also without tariff • Developed between 2017 and 2019
Business plan	• In general, each MW installed costs between 500-900K in capex depending on the size, much of which can be leveraged with bank debt • Equity investment of a 46MW project may require EUR ~10Mn in equity and EUR ~30Mn in debt financing; a 220MW project may require EUR ~20Mn in Equity and EUR ~80Mn in debt financing
Political influence	• None
Ties with other COFDI cases	• These greenfield projects are directly owned by the Chinese State, just like REN and EDP • Licensing a solar park in Portugal requires a lengthy process with input from REN, APA (the Portuguese Environmental agency) and ERSE (the Portuguese agency for energy regulation), all with significant degree of discretion on what regards the speed and priority given to each project • There are many other players trying to license solar projects in Portugal, and these players are afraid that EDP and REN's influence over the process may be resulting in privileged treatment to this consortium; These allegations are not consubstantiated from a legal perspective

Sources: Interviews anonymous competitors; CNBM website; multiple news articles

Corroboration of key propositions and calculation of PIP indicator

CNBM solar greenfield

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• Despite being an energy production asset it is hard to consider it a sensitive industry; Considered mild strategic relevance
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• The buyer is a SOE owned by SASAC
	3. Require controlling stakes and ability to steer the companies' decisions	3	7		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	2		8	• Total investment of EUR ~120Mn (30Mn in equity and 110Mn in debt)
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	2			• Competitors argue that these solar projects received faster treatment than competing processes
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	1 Greenfield			• Pure greenfield
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 irrelevant			• Irrelevant
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Excellent returns (already exited)

Environment

Fosun - Fidelidade

	Fosun	Fidelidade
History of the company	• Fosun was founded in 1992; created as a research company, but due to its entrepreneurship and drive was endorsed by the Chinese state as one of its private companies going global (at the time of the transaction this was still the narrative)	• Grupo Caixa, owned by the Portuguese state, is a financial group which sold 3 insurance companies together: Fidelidade, Multicare and Cares • Fidelidade, the largest insurer in Portugal, results from the 2012 merger of Fidelidade Mundial and Bonança, both with 180+ years of operation
Business activities	• Started from health care, real estate and industrial, moving explosively to pharma, insurance, banking, entertainment, fashion, retail, etc • It is an investment group with private equity funds and direct holdings	• Fidelidade is a non-health insurance company • Multicare is a health insurance company • Cares is the assistance arm of the group
Geographical footprint	• Moved from China to Europe and the USA, but it currently has subsidiaries across the globe	• Portugal represented 98% of the activity; There were also operations in France, Spain, Luxembourg and Macau

(Prior) **Financial performance**	• It grew exponentially via M&A: from 4Bn revenues in 2007 to 5Bn in 2008 and 10Bn in 2015; Profits attributable to the parent company have remained stable at about 10% of revenues	• The performance of the Caixa Grupo was dramatic (EUR > 1Bn of losses)
		• Fidelidade's performance was still positive but reducing sharply
		  • Life premiums reduced from 4.5Bn in 2010 to 2.1Bn in 2012
		  • Non-life premiums reduced from 1.089Bn in 2010 to 1.01Bn in 2012

Ownership and decision makers	• Guo Guangchang, one of the founders is the Chairman and was the "de facto" key decision maker in Fosun at least until 2017-2018 • The Fidelidade operation was executed under his supervision	• State ownership via Caixa Grupo, so the decision was from the government • Key man was (and still is) Dr. Jorge Magalhães Correia, a very seasoned executive; Dr. Rogério Henriques became CEO in 2020
Recent events	• Fosun was in a shopping spree with no boundaries at the time of the transaction	• Severe deterioration of Caixa Grupo and Fidelidade results • Government under Troika program, needing to alienate assets such as this one
Ties with other COFDI cases	• The Fosun investment in Fidelidade was the first among several investments from Fosun in Portugal (BCP, Luz Saúde and less important Star SGPS). The Fidelidade investment in REN is also strongly associated with this investment	

Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, Fidelidade annual reports, 2019 Court of auditors report; Fosun website

Strategy

Fosun - Fidelidade

Acquisition process (including Portugal State involvement)	• The sale of Fidelidade was execute in 2014 in 3 steps: a direct sale of 80%, a public offering of 5% to the employees, and the sale of what was not purchased by the employees to the purchaser • There were only 5 NBOs presented, from which Apollo and Fosun were selected for the binding offer phase • The court of auditors was very critical of the process arguing that: (1) there was insufficient explanation about the process selection; (2) that the selection criteria was changed during the selection period, (3) the independence of the evaluator was not ensured and (4) the proceeds were not maximized
Deal terms and governance model	• Fosun paid EUR 1.038Bn for the first 80% and EUR 61Mn for the remaining 4.86% acquired (employees purchased 0.14%); Grupo Caixa kept 15% • Fosun has absolute control over the company, by having an absolute majority in the shareholders council which nominates the Board of Directors • Dr. Jorge Magalhães Correia, which was already CEO of Fidelidade, remained as the CEO (2020) and President of the Board (still), and is the key local man • ASF, the regulator of the Portuguese Insurance industry, is supposed to maintain a close monitoring of Fidelidade's operation and financial activities
Business plan and synergy expectations	• Fidelidade was the incumbent in the Portuguese market and the main business opportunity was to keep doing what it was doing in Portugal and wait for the turnaround of the Portuguese Economy to get back to pre-crisis profitability levels • Simultaneously, the team should actively look for M&A opportunities in Latam and in the Portuguese private hospital market
Financing mechanism	• Fosun financed itself with Chinese state banks to deploy the EUR >1Bn of the transaction as equity • At the same time, Fosun was very quick to migrate Fidelidade's asset base to debt from Fosun and its subsidiaries (e.g., Club Med)
Seller motivations	• The Portuguese State was under Troika intervention and has signed a MoU committing to sell a number of public assets, among which was Fidelidade, owned by Grupo Caixa (state owned) • The government was focused on selling to the highest bidder and there were very few parties willing to invest in Portugal at the time; Apollo was the other final contender and ended up buying Tranquilidade, Fidelidade's main competitor in the insurance market
Buyer motivations	• Fosun was in a shopping spree in the first half of the 2010s. The strategy was essentially to get hold of whichever assets were available at good prices. It made close to 100 acquisitions in 10+ sectors (Insurance, Banking, Real Estate, Industry, Entertainment, Food and Drinks, Fashion, Retail, Pharma, Health Care, Technology, Media, Investment Management), and insurance was particularly targeted because it gives access to important cash pools • Fidelidade case was a bargain if one considers that Fidelidade makes more than EUR 200Mn in profits per year • Fosun was also able to divert a disproportionate share of the liquidity to finance Fosun abroad

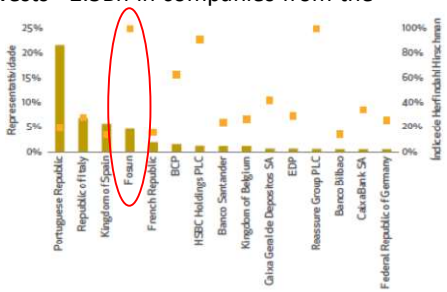
Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, Fidelidade annual reports, 2019 Court of auditors report; Fosun website

Performance

Fosun - Fidelidade

(Post deal) **Financial performance and future prospects**	• Net profits of EUR 272Mn in 2018 and EUR 197Mn in 2019, which is very high for a company which was purchased at a valuation of EUR 1292Mn (~20%/year) • Fidelidade has invested too much in debt from Fosun and its subsidiaries • In Thomas cook alone, it was exposed with EUR 160Mn in a bankruptcy • The critical event of the period post-deal is that Fosun and its *grey rhino* peers went out of control in their shopping spree. The CCP, which witness the exit of EUR 1Tr in 4 years and very fast growth of non-performing loans halted these groups
Evolution and effectiveness of Chinese control	• Fosun remained in full control of Fidelidade throughout the whole period • Since 2016, it still allows Fidelidade to grow in Portugal and abroad but is not willing (nor capable) to deploy additional capital, which limits the impact of the shareholder in the day to day of the company
Evidence of synergies between investor and target	• There has been no relevant operational integration to generate synergies among the target and the investors, with the exception of proximity from Fidelidade to other Chinese owned companies • Some insiders say that Fosun was allowed to continue without an extreme liquidation program (like HNA) because it was deemed "too big in Portugal to fail" by the Chinese authorities
Relevance and potential for political influence	• As the largest insurance company, Fidelidade is also one of the largest employers, asset holders and sponsors in the country. It is seating in a pile of cash and its potential for political influence is extremely high
Concertation with other Chinese companies in PT	• Fosun is the largest Chinese investor in Portugal and coordinates the presence in Fidelidade with its presence in other companies, but also with other Chinese investors in Portugal (e.g., Fosun investing in REN alongside CSGC, Fidelidade investing in Grupo Luz Saúde) and other Fosun investments abroad (e.g., investing its assets in debt from other Fosun companies)
Ability to grow outside Portugal	• Effectively acquire a very large operation in Peru (La positiva) and Bolivia • Grew greenfield in Africa (Angola, Mozambique and Cape Vert)

According to page 42 of the ASF (regulator) report of April 2021 it is possible to extrapolate that Fidelidade invests ~2.5Bn in companies from the Fosun Group



Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, Fidelidade annual reports, 2019 Court of auditors report; Fosun website; ASF Relatório de Estabilidade Financeira Abril 2021

Corroboration of key propositions and calculation of PIP indicator

Fosun - Fidelidade

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	4			• Insurance is a semi-strategic industry but Fidelidade is the incumbent and market maker in the insurance sectors in Portugal
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	2	8		• Fosun is one of the so called grey rhinos: supposedly private groups, heavily financed by the state which went rogue and had to be stopped (and is currently maintained by the party under a very tight leash)
	3. Require controlling stakes and ability to steer the companies' decisions	3			• Full control over the management • Insurance is a regulated industry but the insurance regulator as proven to be too permissive regarding Fidelidade's investments in Fosun and its subsidiaries' debt
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3		10	• Investment above EUR 1Bn
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• Fidelidade used to be owned by the Portuguese state
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	2			• Fosun clearly coordinates activities among its invested companies and even with other COFDI targets
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2/3 Invest in growth			• Fidelidade was already a mature company but Fosun provided the confidence to continue growing, even through M&A (e.g., in Peru)
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	2/4 Some interest in Latam			• Fidelidade was used to enter Peru, but Portugal is not even a country with a deep network in that country
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	3/4 Important			• Fosun considers that there is something to learn from Portugal but this factor was not the main driver of the investment; the low price and the ability to use Fidelidade balance sheet in Fosun's growth path was more important
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Good financial performance (recovered fast to pre-crisis profitability levels)

Environment

Fosun - BCP

	Fosun	BCP
History of the company	• Fosun was founded in 1992; Started as a research company, but due to its entrepreneurship and drive was endorsed by the Chinese state as one of its private companies going global (at the time of the transaction this was still the narrative)	• Founded in 1985 with a very scattered shareholding structure (~200 initial shareholders), grew also through aggressive M&A in Portugal • Controlled by the CEO Jardim Gonçalves until 2005 • BCP was the largest private bank in Portugal in 2015
Business activities	• Started from health care, real estate and industrial, moving explosively to pharma, insurance, banking, entertainment, fashion, retail, etc • It is an investment group with private equity funds and direct holdings	• Banking products and financial services to individuals and companies • Operations in multiple countries
Geographical footprint	• Moved from China to Europe and the USA, but it currently has subsidiaries across the globe; Did not own a bank until 2016	• In 2015 it had 18% share in Portugal, 5% in Poland, 29% in Mozambique and 4% in Angola. It had a private banking operation in Switzerland (sold recently)
(Prior) **Financial performance**	• It grew exponentially via M&A: from 4Bn revenues in 2007 to 5Bn in 2008 and 10Bn in 2015; Profits attributable to the parent company have remained stable at about 10% of revenues • Acquired Hauck & Aufhäuser, a German private bank in 2016	• Dramatic performance since the financial crises, with net income of EUR -840Mn in 2011, EUR -1219 Mn in 2012, EUR -740Mn in 2013, EUR -227Mn in 2014 and EUR +235Mn in 2015 (positive after 4 negative years) • The state had to inject EUR 3Bn in 2012 as an emergency loan to the bank
Ownership and decision makers	• Guo Guangchang, one of the founders is the Chairman and was the "de facto" key decision maker in Fosun at least until 2017-2018 • The operation was executed under his supervision	• Largest shareholder (17%) was Sonangol followed by Banco Sabaddel (5%) • In 2015, the Chairman of the Board was António Monteiro, CEO Nuno Amado (current CEO Migual Maya was already in the Board and Exec. Com.)
Recent events	• Fosun made 10 acquisitions worth EUR 5.4Bn in 2015 • In 2015, Mr. Guo was disappeared for some time, for "reeducation"	• The top 3 private banks were subject to a stress test in 2014 and only BCP failed the test, which implied in the urgent need for capital raise
Ties with other COFDI cases	• The Fosun investment in BCP took place in 2016, already after the temporary disappearance of Guo Guanchang but still before Fosun stopped its shopping spree; Fosun is represented in BCP by Dr. Jorge Magalhães, who is the key man in Fidelidade, but BCP and Fidelidade do not have a commercial agreement since Fidelidade partners with CGD (largest bank, state owned) for commercial distribution	

Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, BCP annual reports, Fosun website

Strategy

Fosun - BCP

Acquisition process (including Portugal State involvement)	• In 2016, Fosun already owner of Fidelidade and Luz Saúde, tried and failed to acquire Novo Banco • In July 2016, Fosun presented a proposal to acquire 16.7% of BCP through a capital injection of EUR 175Mn, and the intention to grow its share over time to 20-30%. In fact, Fosun took advantage of subsequent capital raises
Deal terms and governance model	• Fosun invested EUR 374Mn in 2017 and EUR 140Mn in 2018 reaching 27% in 2018 (and 29.93% in Dec 2020) • The Bank maintains a governance model with a Board of Directors (presided by Nuno Amado) and an Exec. Com. (Miguel Maya is the CEO); Fosun is represented by Dr. Magalhães Correia in the Board (VP) and three Chinese citizens • No one controls the Board because there is a maximum of 25% voting rights for any shareholder, independently from its equity. Because it is the largest shareholder and the structured is very fragmented, Fosun has an important influence over the definition and the undertakings of the Exec. Com. and maintains a close relationship with the CEO
Business plan and synergy expectations	• The strategy for BCP was to transform the bank to make it more agile, simpler and leaner, while exploiting growth opportunities in the operations in Poland, Angola, Mozambique and making for the repayment to the state • Fosun was not yet in banking and wanted to gain some track record (and know-how) on it
Financing mechanism	• Fosun had access to Chinese state financing, which was also used for this acquisition • By 2015, Fosun already had a debt of EUR 15Bn for less than EUR 1Bn annual profits (attributable to the shareholder)
Seller motivations	• The bank accumulated EUR 3Bn losses in 2011-2014 and the state had to loan EUR 3Bn to the bank but there was a restructuring plan (approved by the EU) which included cost cuttings, capital raises and subsequent debt repayment
Buyer motivations	• Fosun was in a shopping spree in the first half of the 2010s. The strategy was to get hold of whichever assets were available at good prices. It made close to 100 acquisitions in 10+ sectors (Insurance, Banking, Real Estate, Industry, Entertainment, Food and Drinks, Fashion, Retail, Pharma, Health Care, Technology, Media, Investment Management) • Owns a private banking in Germany (Hauck & Aufhäuser, since 2016), but BCP is the most relevant banking operation

Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, Fidelidade annual reports, Fosun website

Performance

Fosun - BCP

(Post deal) **Financial performance and future prospects**	• BCP was able to return to profitability in post deal period, with a net income attributable to the shareholders of EUR 24Mn in 2016, 186Mn in 2017, 301Mn in 2018 and 302Mn in 2019 • The critical event of the post-deal period is that Fosun and its peer (the "supposedly") private companies Anbang, HNA and Dalian Wanda) were considered out of control in their shopping spree. The CCP, which witness the exit of EUR 1Tr in 4 years and very fast growth of non performing loans stopped these groups, which were called grey rhinos • Fosun is no longer willing to invest further in BCP
Evolution and effectiveness of Chinese control	• Fosun remained behaving as a responsible shareholder throughout the period and BCP's Exec. Com. maintained a close relationship with Fosun – Fosun remains an influential shareholder without active control over the operations • Fosun's inability to invest further reduces its influence in the bank (which presumably needs more capital due to pandemic effects)
Evidence of synergies between investor and target	• There was no expectation for synergies beyond the interest of Fosun in gaining track record and credibility in the banking industry; the Group's problems in other geographies and industries led to a significant change in the Fosun's bandwidth but without impact in BCP • Some insiders say that Fosun was allowed to continue without an extreme liquidation program (like HNA) because it was deemed "too big in Portugal to fail" by the Chinese authorities
Relevance and potential for political influence	• As one of the largest banks in the country, BCP is also one of the largest employers, asset holders and sponsors in the country. Its potential for political influence is extremely high • The fact that Fosun does not have absolute control over BCP mitigates the situation
Concertation with other Chinese companies in PT	• Fosun is the largest Chinese investor in Portugal and coordinates the presence in BCP with its presence in other companies but in the case of BCP this effect is mild
Ability to grow outside Portugal	• This was not a priority for this investment

Sources: Interviews to Dr. Jorge Magalhães Correia, Dr. Diogo Lacerda Machado, Fidelidade annual reports; Fosun website

Corroboration of key propositions and calculation of PIP indicator

Fosun - BCP

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	4	7	8.5	• Banking is a strategic industry for all FDI regulatory bodies and BCP is one of the largest banks in Portugal
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	2			• Fosun is one of the so called grey rhinos: supposedly private groups, heavily financed by the state which went rogue and had to be stopped (and is currently maintained by the party under a very tight leash)
	3. Require controlling stakes and ability to steer the companies' decisions	2			• Fosun is the largest shareholder and the most influential shareholder but does not have absolute control over the management
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3			• Investment started at EUR 175Mn but quadrupled in the meantime
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• The government had to loan EUR 3Bn to BCP and was actively involved in finding a new shareholder willing to capitalize the bank in the short and medium term
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1.5			• Fosun clearly coordinates activities among its invested companies and with other COFDI targets but in BCP this effect is milder
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	3/3 Mature asset			• The capital injections in BCP are meant to repay the State's loan and mantain BCP afloat
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 Irrelevant			• Growth in other countries was not a priority
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	4/4 Top priority			• Fosun's investment was motivated by the access to banking know-how and track record
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Good financial performance until 2019

Two investments adjacent to Fosun investments in Fidelidade and BCP Fosun – Fidelidade/BCP

	Fosun investment in Luz Saúde	Fosun investment in Star SGPS
Who	• Luz Saúde used to be Espírito Santo Saúde, part of Espírito Santo Group which owned also Tranquilidade (2nd largest insurance company) • Is one of the two largest private health care chains in Portugal	• Star SGPS is the holding company of Jorge Mendes, one of the best soccer agents in the world • It owns and trades sports rights, namely soccer athletes
Deal	• Fidelidade acquired Luz Saúde from the stock market in a public offering for EUR 460Mn in 2014 • In 2017, Fidelidade sold 49% of Luz Saúde to Fosun itself • The new shareholders supported the company it its growth strategic, opening and acquiring new hospitals in clinics across the country • Luz Saúde doubled in size since the acquisition	• In 2015, year when it generated 25Mn profits, Fosun acquired 15% and an option to acquire additional 37.5% • Fosun paid EUR 42Mn • Since then, Star and Fosun have been working together in several deals, the most famous being the acquisition of Premier League's Wolverhampton
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: • Sensitiveness: Irrelevant (1) • Government ownership: Statepowered (2) • Level of Control: Absolute (3) • Deal size: Large amount (3) • Government touting: Yes (1) • Concertation with other COFDI: Potential conflict (2)	• For PIP purposes this transaction has the following attributes: • Sensitiveness: Sensitive (1) • Government ownership: SOE (2) • Level of Control: Word-to-say (1) • Deal size: Large amount (1) • Government touting: Yes (1) • Concertation with other COFDI: Potential conflict (1)
PIP	• Therefore, the estimated PIP is: • Version 1: 5 • Version 2: 6	• Therefore, the estimated PIP is: • Version 1: 1 • Version 2: 1

Environment

Beijing water – Veolia water

	Beijing Enterprises Water Group (BEWG)	Veolia water Portugal
History of the company	• BEWG is a HK-based company engaged in water businesses • It is owned by Beijing Enterprises Holdings Limited (BEHL) which is owned by the People's Government of Beijing Municipal; BEHL is the largest utility in China	• Founded in 1853 as the French general water company, Veolia group is the global leader in optimized resource management • Has 180K employees worldwide
Business activities	• (1) Sewage and reclaimed water treatment and construction • (2) Water Distribution Services • (3) Technical and Consultancy Services	• Veolia provides water, waste and energy management solutions • The Portuguese operation operates water and waste businesses • 450 employees, 130K water customers and 90K waste customers
Geographical footprint	• Portugal, Angola, Botswana, Singapore, Malaysia, New Zealand, Australia, Taiwan, Macao and China Mainland	• France, Spain, UK, Morocco, USA, Canada, Mexico, Colombia, Argentina, China, India, Japan, Australia, among others
(Prior) **Financial performance**	• From 2010 to 2013 it grew from EUR 120Mn to 600Mn in revenues and EUR 40Mn to EUR 120Mn in profits. In 2013 alone, it grew 72% in revenues and 44% in profits	• Veolia group is the largest water and waste operator in the world with EUR ~25Bn in sales • Before the deal Veolia PT had ~42Mn in sales and ~8Mn EBITDA
Ownership and decision makers	• It is state owned (via Beijing municipality) • Key men: Mr. Li Yongcheng (Chairman) and Mr. Zhou Min (CEO) • For Portugal, the key man is Alberto Carvalho Neto (local CEO)	• Listed in Paris Euronext with a fragmented shareholding structure • Key decision maker is Antoine Frerót
Recent events	• Aims to be the leading water and environment provider	• Decide to alienate operations in secondary countries and focus on priority markets
Ties with other COFDI cases	• Despite being state owned, BEWG does not have close ties with any other COFDI case in Portugal	

Sources: Interview to Mr. Alberto Carvalho Neto, Veolia annual reports, BEWG annual reports

Strategy

Beijing water – Veolia water

Acquisition process (including Portugal State involvement)	• Direct sale from the Veolia to BEWG for EUR 95Mn
Deal terms and governance model	• Absolute control • Operates concession contracts in highly regulated sectors
Business plan and synergy expectations	• The Portuguese operation could profit from BEWG's know-how and scale • Portugal could be used as a testing ground for international expansion
Financing mechanism	• Access to financing from Chinese (public) banks
Seller motivations	• Desire to focus on priority countries • The operation was not generating cash and could be alienated for a high cash value (EBITDA of 1Mn vs. 95Mn price paid)
Buyer motivations	• BEWG intends to become the leading player in the field and Portugal was a testing ground for its international expansion

Sources: Interview to Sources: Interview to Mr. Alberto Carvalho Neto, Veolia annual reports, BEWG annual reports

Performance

Beijing water – Veolia water

(Post deal) **Financial performance and future prospects**	• Despite stable revenues, Be Water Portugal has performed very well, with its EBITDA grown from 8Mn to 20Mn/year and debt reduced from 60Mn to 30Mn • BEWG grew exponentially (5x growth in 6 years) to EUR 3Bn sales and EUR 600Mn profits in 2019
Evolution and effectiveness of Chinese control	• Absolute control over the company, but in a highly regulated sector which operates concession contracts
Evidence of synergies between investor & target	• The Portuguese operation has gained from BEWG know-how and scale with clear financial improvement • Portugal worked as a test ground (in parallel with Malaysia) before expansion to other geographies
Relevance and potential for political influence	• Water is a very sensitive service but BEWG owns only a very small portion of the market (2%) and operates a concession contract which can be reverted in case of disruption or other safety concern
Concertation with other Chinese companies in PT	• No coordination with other COFDI cases
Ability to grow outside Portugal	• Not yet, but there are efforts to sell in Germany and Greece

Sources: Interview to Mr. Alberto Carvalho Neto, Veolia annual reports, BEWG annual reports

Corroboration of key propositions and calculation of PIP indicator

Beijing water – Veolia water

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• Water is a sensitive service but the operation is only 2% of the total market and it is a very regulated sector
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• State owned via the Beijing Municipality
	3. Require controlling stakes and ability to steer the companies' decisions	3	7		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	2		7	• Medium size (EUR 95Mn)
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No coordination
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	1/3 Pure holding			• No investment
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	2/4 Interest in foreign experience			• Interested in gaining experience (including regulatory know-how) in foreign markets
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Excellent financial improvement

Greenfield investment

Huawei greenfield

	Huawei
History of the company	• Huawei, founded in 1987 and headquartered in Shenzhen, is a leading telecom equipment (infrastructure and smartphone) provider globally • In 2019, it had +190K employees, revenues of EUR 130Bn and profits of EUR 10Bn worldwide; Grew 4x since 2012 • The company argues that it is wholly private and owned by its employees, but everyone considers it to be an SOE • It is known that it was founded by a former PLA officer and it is believed that it grew with the help of the PLA and providing services to it

Business activities	• It sells equipment to three main segments
	  • Sales to Telecom operators, which reduced from 73% in 2014 to 35% in 2020
	  • Sales to Consumers, which grew from 21% in 2014 to 54% in 2020
	  • Sales to Corporations, which grew from 6% in 2014 to 11% in 2020

Performance	• Sells EUR 61Bn per year
The project	• In 2012, invested EUR 10Mn in a technological center in Lisbon • The tactical objective is to grow market share in equipment sales (as it did) • The strategic objective is to enable the sale of 5G equipment to the Telecom operators in Portugal (which require governmental approval)
Business plan	• From 2013 until 2015, Huawei revenues grew from EUR 65Mn to EUR 235Mn, in line with the plan • 5G, which will enable a much higher virtualization of the society and the economy, will soon be a critical infrastructure in every country; Huawei is betting on Portugal to be one of the first EU member states to brake ranks and accept Huawei as a provider • Government and intelligence officials believe that being the supplier of the 5G infrastructure allows for massive espionage, but also that this is true with every equipment provider • Portugal is under active pressure from the USA to refuse the participation of Huawei in its 5G network
Political influence	• Access to the telecom core networks enables espionage so it is a critical industry with very high potential for political influence • Smartphone equipment in itself is less sensitive than the core network
Ties with other COFDI cases	• Not relevant

Sources: Statcounter, Huawei annual reports, interviews to Dr. Nuno Rogeiro, Dr. Marcelo Rebelo de Sousa, Dr. Diogo Lacerda Machado, Dr. Miguel Relvas, Dinheiro Vivo

Corroboration of key propositions and calculation of PIP indicator

Huawei greenfield

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• Telecom infrastructure equipment has strategic relevance but until Huawei is allowed to provide 5G equipment in Portugal the sensitiveness is only mild
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• Despite presenting itself as a private company all the interviewees share that the intelligence informs that Huawei is indeed state owned
	3. Require controlling stakes and ability to steer the companies' decisions	3	6		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	1		6	• Total investment of EUR ~10Mn
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No coordination
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	1/3 Greenfield			• Pure greenfield
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	4/4 Entry door to the EU			• Being able to have a few EU member states willing to use Huawei in its 5G infrastructure is an important objective of China
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• Excellent returns (already exited)

Greenfield investment

COFCO greenfield

	China Oil and Foodstuffs Corporation (COFCO)
History of the company	• Founded in 1949, COFCO has become a leading supplier of agribusiness products • Owned by SASAC, it is a holding of 12 major subsidiaries all listed in the stock market • It is the largest in China and is growing abroad where it already has 50% of its business • 111K employees worldwide
Business activities	• Main products are grain, oil, sugar and cotton • Other products include meat, diary, wine and tea • It works across all steps of the value chain, from production to process and distribution
Performance	• It is too early to tell since the investment started in 2019
The project	• Invest EUR 10M in setting up an operational centre • Mostly focused in IT, financial and procurement professionals • Expected to reach 400 employees in 2021
Business plan	• NA
Political influence	• Not relevant
Ties with other COFDI cases	• Not relevant

Sources: AICEP; COFCO website

Corroboration of key propositions and calculation of PIP indicator

COFCO greenfield

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	1			• Trading of agribusiness products is not a sensitive activity
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	4			• COFCO is a SOE under SASAC
	3. Require controlling stakes and ability to steer the companies' decisions	3	5		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	1		5	• Total investment of EUR ~10Mn
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	1			• No involvement
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No coordination
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	1/3 Greenfield			• Pure greenfield
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	2/4 Some interest in the EU			• Hiring several hundred westerners in Portugal and locating them inside the EU helps with accessing the European market
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• No intention to acquire know-how
	9. COFDI in Portugal has had good economic performance	2/2 Reasonably well			• The activity in Portugal is a cost center where it is possible to hire experienced western professionals at good wages

Environment

Haitong - BESI

	Haitong	BESI
History of the company	• Founded in Shanghai, in 1988, by the Bank of Communications for providing securities related services • 2nd largest Chinese investment bank; 7.5K employees	• It was the investment bank of Grupo Espírito Santo (30 years) • It was the most important investment institution and led all the important deals (e.g., including the sale of EDP to CTG)
Business activities	• Its business includes brokerage, investment banking, M&A, asset management, funds, margin trading, short selling, futures, and PE investment	• Investment banking, client origination, private Banking, capital markets, fixed Income, corporate Finance, M&A, SME advisory, project finance and securitization, asset management, PE, etc
Geographical footprint	• China, Hong Kong, Macau and Singapore	• Portugal, Spain, Brazil, United Kingdom, Poland, Germany, USA, Mexico, India, Hong Kong, Angola Mozambique, Malaysia, Turkey, Cayman and China
(Prior) **Financial performance**	• 3Bn Revenues and EUR 900Mn profits in 2015	• EUR 250Mn revenues and EUR 89Mn profits in 2015, in line with the previous years; A lot came from consulting fees leveraging the group's influence, and operations coming from the group
Ownership and decision makers	• Publicly traded company with multiple SOEs in its shareholding structure	• Formerly owned by Grupo Espírito Santo and led by Dr. José Maria Ricciardi (CEO) and the CEO of Grupo Espírito Santo Dr. Ricardo Salgado (Chairman of the Board of BESI)
Recent events	• Actively looking for opportunities to grow overseas (and pioneer among Chinese Securities businesses in doing so)	• Grupo Espírito Santo went bankrupt in 2014
Ties with other COFDI cases	• Not relevant	

Sources: Interviews to Haitong Board Members who agreed to talk only under confidentiality; Haitong and BESI annual reports

Strategy

Haitong - BESI

Acquisition process (including Portugal State involvement)	• This process happens in the context of the bankruptcy of Grupo Espírito Santo (GES) and its bank Banco Espírito Santo (BES) • BES was intervened by the *Banco de Portugal* (BdP) and Novo Banco was created in August 2014 • BESI was not intervened by BdP but Dr. Ricciardi was recommended to find an alternative owner for BESI, which would avoid an intervention/investigation (BESI was involved in the sale of financial products from GES and BES) • Dr. Ricciardi found a buyer in a rapid and poorly known process and Novo Banco sold BESI to Haitong • The BdP pressured Novo Banco's new CEO (Dr. Stock da Cunha) to aprove the sale
Deal terms and governance model	• Purchase of 100% of the company for EUR 379Mn • Further injections sum EUR 518,5Mn and can be broken down as follows: EUR 100Mn in Dec 2015; EUR 60Mn in May 2017, EUR 320Mn in June 2017; EUR 38,5Mn in August 2017;
Business plan and synergy expectations	• Haitong Bank's strategy is to leverage on the opportunities emerging from China's internationalisation, combining its expertise in Western markets with the Group's cross-border origination and distribution. Haitong Bank tries to build profitable growth opportunities with a China Angle
Financing mechanism	• Access to financing from Chinese (public) banks
Seller motivations	• With the demise of Grupo Espírito Santo, the government took over the responsibility of ensuring business continuity to BES and BESI • The main selling criteria was finding someone willing to inject capital to make up for the losses which were expected
Buyer motivations	• A very large and state powered Chinese securities firm was looking forward to expand its activities abroad and was difficult to find a banking institution with so many banking licenses to operate across all continents

Sources: Interviews to Haitong Board Members who agreed to talk only under confidentiality; Haitong and BESI annual reports

Performance

Haitong - BESI

(Post deal) **Financial performance and future prospects**	• Massive losses (-29Mn in 2014, -43Mn in 2015, -96Mn in 2016, -130Mn in 2017) followed by breakeven in 2018-2020 • The shareholder had to inject additional EUR 518,5Mn to cover for the losses incurred • Without its relationship with the commercial bank, the investment bank lost its commercial pipeline, and the assets of the bank proved to be worth less than what was reflected on the bank's accounts
Evolution and effectiveness of Chinese control	• Full control throughout the period • Very difficult relationship between the Portuguese management and the shareholder
Evidence of synergies between investor & target	• The business activity has reduced significantly since the acquisition and it seems that the new shareholder was not capable of making up for the loss of the relationship with the commercial bank (now called Novo Banco) and the former leadership (Dr. José Maria Ricciardi and Dr. Ricardo Salgado)
Relevance and potential for political influence	• Despite having the potential to be used for wrongdoing (e.g., biased sales processes), it is not an asset with very high potential for political influence • In China, Haitong is under scrutiny by the bank authorities which identified controlling and compliance issues
Concertation with other Chinese companies in PT	• Unnoticed
Ability to grow outside Portugal	• Unnoticed

Sources: Interviews to Haitong Board Members who agreed to talk only under confidentiality; Haitong and BESI annual reports

Corroboration of key propositions and calculation of PIP indicator

Haitong - BESI

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• (Investment) banking licenses are sensitive because they are powerful financial tools, but are only considered mild sensitive for political influence purposes
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	2			• The shareholding structure includes both SOEs and private institutions in a very fragmented manner, reason why it is considered statepowered instead of SOE
	3. Require controlling stakes and ability to steer the companies' decisions	3	6		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	3		7	• Large investment (EUR ~900Mn)
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• The Portuguese government was actively involved in resolving the Banco Espírito Santo bankruptcy, including the sale of BESI
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No interaction
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2 Save troubled asset			• The company was purchased with the intention to develop its businesses, even if what happened was a substantial decrease in its activity
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 irrelevant			• The acquisition objective was to take advantage of the existing licenses
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	3/4 Access to banking licenses abroad			• The acquisition objective was to take advantage of the existing licenses and regulatory know-how in the countries where the bank operates
	9. COFDI in Portugal has had good economic performance	1/2 Dramatic performance			• The losses incurred raised the toll in EUR ~0.5Bn

Environment

Bison - BanifBI

	Bison	Banif Banco de Investimento (BBI)
History of the company	• Bison Capital Financial Holdings (Hong Kong) Limited is owned by Bison Capital Holding Company Limited • The group attempted to register as ultimate beneficial owners (UBO) in the *Banco de Portugal* (BdP) opaque firms based in the British Virgin Islands • Mr. Feng Yin Jiang, who shows as UBO, is unknown to the structure; Mr. Bian Fang, the appointed CEO, worked before at the Bank of China International • Multiple sources indicate that this group was part of a USD ~100Bn fund which was created (with state financing) to invest overseas, but it was stopped in 2019 and is being subject to smooth liquidation • The founder was Mr. Peixin Xu, a university researcher (Peking) and media/tech businessman (founder of *RedBaby*) , who has made multiple investments in film and TV production, film distribution and entertainment-related mobile Internet services, including Bona Film, Xunlei and Weiying Technologies, and Cinedigm • Many of these investments were executed through a special purpose acquisition vehicle (SPAC) listed in the USA	• Banif Bank was created in 1988 by Mr. Horácio Roque • BBI was created by Banif Bank in 2002 and was the group's investment bank
Business activities		• Provision of typical investment banking activities, such as advisory Services, Treasury & Markets, Trading & Sales, Private Equity and others
Geographical footprint		• Portugal, Brazil, Bahamas, Canada, South Africa, USA and Venezuela
(Prior) **Financial performance**		• Banif Bank was in a troubled financial situation and in December 2013 TVI announced to the public that the bank was about to close, which precipitated a bank run and a state intervention
Ownership and decision makers		• Previously owned by Banif bank, lead by Dr. Jorge Tomé (CEO) and Dr. Teresa Roque (owner), after the intervention it was managed by Oitante, a vehicle created by the BdP
Recent events		• With the demise of Banif, Oitante was charged to alienate BBI and other assets at the highest possible value
Ties with other COFDI cases	• Not relevant	

Sources: Interviews to employees, annual reports

Strategy

Bison - BanifBI

Acquisition process (including Portugal State involvement)	• The BoP intervened in Banif by selling the main bank to Banco Santander Totta and parking the remaining assets in a special purpose vehicle named Oitante • Oitante, which was charged with the task of alienating the remaining assets at the highest possible value sold BBI to Bison in 2018
Deal terms and governance model	• In exchange for 100% of BBI, Bison promised to inject EUR 60Mn in BBI • There was a first injection of EUR 41Mn, but the remaining amounts were not paid in time. EUR 5.7Mn were paid in 2020 and the remaining amount was paid in February 2021
Business plan and synergy expectations	• The initial objective was to use the bank to intermediate and facilitate Chinese M&A transactions in the west • The first year of ownership was marked by difficulties in approving the management team and resistance from the structure to use the bank for the original purpose • Since 2019, Bison Bank defined a new strategy focused on attracting and serving as an advisor to Chinese wealthy individuals in Europe, and becoming a reference service provider to Portuguese private equities and investment groups
Financing mechanism	• At first, the group had access to (bank) state financing for its acquisitions overseas, but in the meantime it was deemed a grey rhino and stopped. This explains why the group could not fulfil its capital injection obligations
Seller motivations	• The special purpose vehicle Oitante, which owned BBI was created precisely to alienate the assets from former Grupo Banif
Buyer motivations	• As mentioned, the objective was to use the bank to intermediate and facilitate Chinese M&A transactions in the west

Sources: Interviews to employees, annual reports

Performance

Bison - BanifBI

(Post deal) **Financial performance and future prospects**	• BBI's performance has been terrible, losing EUR 42Mn in 2017, EUR 9Mn in 2018 and again EUR 9Mn in 2019
Evolution and effectiveness of Chinese control	• Despite owning the bank, the shareholder was not capable of fulfilling its capital commitments in time which resulted in concerns from both the BdP and the employees • The bank has been informally for sale since early 2020 but current value of the bank is well below the amount invested
Evidence of synergies between investor & target	• The new strategy of attracting Chinese wealthy individuals is not picking up, partly because the Bison group is perceived to have been intervened by the Chinese state and being under liquidation
Relevance and potential for political influence	• Despite having the potential to be used for wrongdoing (e.g., biased sales processes), it is not an asset with very high potential for political influence
Concertation with other Chinese companies in PT	• Unnoticed
Ability to grow outside Portugal	• Unnoticed

Sources: Interviews to employees, annual reports

Corroboration of key propositions and calculation of PIP indicator

Bison - BanifBI

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• (Investment) banking licenses are sensitive because they are powerful financial tools, but are only considered mild sensitive for political influence purposes
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	2			• The shareholding structure it considered statepowered as the other grey rhinos
	3. Require controlling stakes and ability to steer the companies' decisions	3	5		• Full control
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	2		6	• Medium sized investment (EUR ~42+6Mn until 2019, but EUR 60Mn until 2021)
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2			• BdP nominated Oitante, a special purpose vehicle to sell the asset, and the Portuguese government was actively involved in finding a solution to BBI
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No interaction
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2 Save troubled asset			• The company was purchased with the intention of using its licenses for new businesses (Chinese M&A advisory)
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	1/4 irrelevant			• The acquisition objective was to take advantage of the existing licenses
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	3/4 Access to banking license			• The acquisition objective was to take advantage of the existing license
	9. COFDI in Portugal has had good economic performance	1/2 Dramatic performance			• The losses incurred meant that the EUR injected have already evaporated

Environment

HNA-TAP

	HNA	TAP
History of the company	• HNA is a small airline turned into one of the largest conglomerates worldwide (via M&A)	• Founded in 1945 is the Portuguese anchor airline
Business activities	• 450+ interests in aviation (Hainan + 13 others), real estate (13 airports, + 50Mn sqm construction), financial services (leasing + insurance), tourism, and logistics among others	• Air transport services
Geographical footprint	• Global	• With the main hub in Lisbon, serves multiple destinations in Europe, the Americas, Africa and Asia
(Prior) **Financial performance**	• HNA was in a shopping spree, including massive acquisitions (Avalon for USD 2.6Bn, Swissport for USD 2.8Bn, Ingram Micro for USD 6bn, gategroup for USD 1.5b and Hilton for 6.5Bn)	• Poor performance (e.g., EUR2.4Bn sales and EUR 120Mn losses in 2015, and EUR 2.5Bn sales and EUR 46Mn losses in 2014)
Ownership and decision makers	• Founder Chen Feng is believed to be supported by Politburo member Wang Qishan, who was CEO of the agriculture investment trust when Chen worked there	• 100% state owned until 2015
Recent events	• The shareholding structure remains opaque: was 70% owned by the Hainan traffic administration holdings in the 2000, and is currently owned (52.5%) by two charity foundations	• Portugal was under Troika intervention and the privatization of TAP was part of the MoU between Portugal and Troika
Ties with other COFDI cases	• Not relevant	

Sources: Interviews to Dr. Frasquilho, Dr. Lacerda Machado, Annual reports, Financial Times, Collier 2018

Strategy

HNA-TAP

Acquisition process (including Portugal State involvement)	• Competitive bid process (2015) in which German Efromovich, owner of Avianca, was the main competitor • The process was managed by Parpública, the public holding, and had several criteria including the amount injected, the valuation of the company, the strategic plan, the execution guarantees and the industry experience • It first aimed at privatizing 61% but the process was later changed (by the new government to maintain 50% public)
Deal terms and governance model	• The winner was Atlantic Gateway, owned by Azul and Humberto Pedrosa, which offered EUR 10Mn cash out and EUR 337.5Mn cash in, of which 120Mn was a convertible loan • In this context, HNA, who could not bid because the process required local ownership, acquired 23.7% of Azul • In 2016, HNA purchased directly 35% of the convertible bonds for EUR 30Mn
Business plan and synergy expectations	• The business plan included a significant growth in TAP routes to the USA and later to Asia • The commercial synergies between the airlines were obvious • It is said that Azul did not have to invest much in net terms because it used TAP ownership to alienate aircrafts to TAP
Financing mechanism	• Until 2018 HNA had strong financing capacity with the largest Chinese banks, including the China Development Bank and the Export-Import Bank of China; It was HNA's entrance in Azul which gave it liquidity to acquire TAP
Seller motivations	• It was mandatory and part of the Troika intervention program
Buyer motivations	• HNA was keen to acquire even more airlines to its portfolio, particularly in the EU • Azul wanted to use TAP as an operational partner to add EU and African traffic to its American traffic • Azul was also interested in using TAP to acquire its older aircrafts and some aircraft obligations which could not fullfil

Sources: Interviews to Dr. Frasquilho, Dr. Lacerda Machado, Dra. Filipa Alarcão, Dra. Maria Luis Albuquerque, Dr. Sérgio Monteiro; Annual reports, Financial Times, Court of auditors

Performance

HNA-TAP

(Post deal) **Financial performance and future prospects**	• TAP financials improved and, by the end of 2019, Lufthansa made an non-bidding offer for 1Bn • HNA's direct investment in TAP was recovered later when it sold its share for EUR 48.6Mn • HNA made a loss in its overall investment in Azul since in entered for EUR 450Mn and sold it later for less • The critical point to mention is that by 2020 the Chinese government stopped backing HNA and allowed it to bankrupt owing ~EUR 100Bn • The group has been liquidating its equity ownerships and Mr. Cheng Feng was blacklisted
Evolution and effectiveness of Chinese control	• HNA did not control Azul nor TAP directly, but it had a word to say in both
Evidence of synergies between investor & target	• There were clear commercial synergies among the airlines involved in the transaction
Relevance and potential for political influence	• The influence potential was minimal because the State kept 50% of the company; If the state's share was lower and HNA had control over the Atlantic Gateway consortium, the potential would be important
Concertation with other Chinese companies in PT	• Unnoticed
Ability to grow outside Portugal	• TAP and Azul grew their commercial network, but HNA did not extend its ability to grow abroad because of this transaction

Sources: Interviews to Dr. Frasquilho, Dr. Lacerda Machado, Dra. Filipa Alarcão, Dra. Maria Luis Albuquerque, Dr. Sérgio Monteiro; Annual reports, Financial Times, Court of auditors

Corroboration of key propositions and calculation of PIP indicator

HNA-TAP

Proposition		Grade	PIP V1	PIP V2	Rationale
Top 3 propositions	1. Concentrated on strategic assets, sensitive Industries or players with dominant position which could be leveraged	2			• Airlines are sizeable agents in their economies and can create positive externalities, but are only considered mild strategic for influence purposes
	2. Predominantly executed by companies with very close ties to the Chinese Government, being it SOEs or *statepowered* private	2			• HNA was one of the so called grey rhinos, which are considered statepowered in this analysis
	3. Require controlling stakes and ability to steer the companies' decisions	1	2		• HNA did not control Azul nor TAP directly, but it had a word to say in both
Size	FDI volume above 360Mn (>0.2% of 2015 GDP) is very large, and below 45Mn (<0,025% of 2015 GDP) is small	1			• Small investment (EUR 30Mn) if we include only the EUR 30Mn of bonds purchased from Atlantic Gateway; indirectly, via Azul, the exposure was higher
Other 2 propositions part of extended PIP formula	4. Assets which were actively touted by the Portuguese government	2		3	• The government was the seller and a future partner, and was deeply involved in the transaction
	5. COFDI investors in Portugal tend to coordinate their business activities among themselves	1			• No interaction
Remaining 4 propositions (not part of PIP formula)	6. Mature assets, not so much on greenfield projects or those responsible for significant job creation;	2 Invest in growth			• HNA meant to be an enabler of TAP's growth in Asian routes
	7. Portugal works as an entry door in 3rd countries because COFDI is executed by companies searching for market access	2/4 Some interest in the EU			• HNA was interested in accessing the European airline business
	8. Concentrated on companies from where know-how can be extracted than on companies where the investor can add value;	1/4 Irrelevant			• HNA already had significant airline expertise
	9. COFDI in Portugal has had good economic performance	1/2 Poor performance			• Azul and TAP were not able to turn their financial situation around

Two Tianying investments in SUMA/EGF (via urbaser) and UNA

Tianying – SUMA and UNA

	Tianying investment in SUMA	Tianying investment in UNA
Who	• Tianying Inc is a private waste management company which is growing abroad in search for diversification (both geographical and sectorial)	
Deal	• Firion investments is an investment fund, owned by Huayu, another investment fund, which is mostly finance by the Chinese state but also by Jiangsu Dagang Lts and China Tianying Inc • In 2016, Firion acquired Urbaser (waste management company) from Spanish ACS for EUR 1.16-1.4Mn • In 2018, Tinaying buys Urbaser from Firion • Urbaser owns 38.5% of SUMA, which owns 100% of EGF, a waste management company privatized by Parpública in 2015, for EUR 150Mn, therefore Urbaser's equity in SUMA is worth ~57.75 • The remaining 61.5% is owned by Mota-engil	• Groupama, international insurance company sold its Portuguese operation to Tianying in a competitive bid in 2017 for an undisclosed amount, estimated at EUR 70Mn • Tianying, which had no experience in insurance hired the experienced Chinese insurance executive Michael Lee from Fosun, to be the CEO of the insurance company, rebranded as UNA • Tianying's founder and Chairman Mr. Yan Shengjun is, similarly to Mr. Guo Guangchang from Fosun, an admirer of Warren Buffet and his vision about insurance companies as a source of liquidity • Tianying's entrance in UNA is a learning step
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: • Sensitiveness: Mild sensitive (2) • Government ownership: Statepowered (2) Despite presenting itself as private, the links with state funding are very clear • Level of Control: Word-to-say (1) • Deal size: Medium size (2) • Government touting: No (1) COFDI came after the privatization • Concertation with other COFDI: No concertation (1)	• For PIP purposes this transaction has the following attributes: • Sensitiveness: Mild sensitive (2) • Government ownership: Statepowered (2) Despite presenting itself as private, the links with state funding are very clear • Level of Control: Absolute (3) • Deal size: Medium size (2) • Government touting: No (1) • Concertation with other COFDI: No concertation (1)
PIP	• Therefore, the estimated PIP is: • Version 1 : 3 • Version 2: 3	• Therefore, the estimated PIP is: • Version 1 : 5 • Version 2: 5

National Fisheries investment in Mar Fresco

	CNFC)
Who	• China National Fisheries corp. (1985), an SOE owned by SASAC, is the largest multi-national fisheries enterprise of China • 220+ ships operating in the Atlantic Ocean, Indian Ocean, Arabian Sea and Mediterranean sea • Marfresco, founded by the CEO Rui Sousa 30 years ago, is the largest Portuguese distributor or seafood (EUR 20Mn sales) • CNFC bought a Japanese fishing company which was Marfresco's main supplier (Madagascar shrimp)
Deal	• CNFC, which does not own distributors in any country, got increasingly interested in entering Marfresco in order to gain distribution know-how in Europe • CNFC acquired 51% of Marfresco in 2016 for an estimated amount of EUR 4Mn, but Rui Sousa remains as CEO of the company and CNFC and SASAC let him run the day to day of the company without intervention
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Irrelevant (1) •Government ownership: SOE (4) •Level of Control: Control (2) •Deal size: Small (1) •Government touting: No (1) •Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: •Version 1: 4 •Version 2: 4

KNJ investment in Global Media

	CNFC)
Who	• KNJ global holdings limited is an investment company owned by Kevin Ho, nephew of the first chief executive of Macau Edmund Ho; KNJ is experienced with real estate development • Global Media is the 4th largest media group in Portugal (newspapers, radio, newspapers distribution), which was in a very difficult financial situation, burning more than EUR 600K per month • Other shareholders of Global Media include Dr. Pedro Soeiro representing Angolan interests, seasoned media businessman Joaquim Olveira and two banks (BCP and Novo Banco)
Deal	• KNJ invested EUR 15Mn for 30% of Global Media; In parallel it was agreed that it would buy the HQ building for a set price • KNJ guaranteed that Global Media ventured into some new businesses (online gaming) but did not have control over the daily operations • The EUR 15Mn invested in the end of 2017 were lost (operationally) in ~2 years
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Sensitive (4) – Media is among the most sensitive industries for political influence •Government ownership: Statepowered (2) Despite the political relationship, Chinese sources refer this is non-official FDI •Level of Control: word-to-say (1) •Deal size: Small (1) •Government touting: No (1) •Concertation with other COFDI: Light concertation (1.5) – the group maintains an non-critical (editorial) line towards COFDI
PIP	• Therefore, the estimated PIP is: •Version 1: 4 •Version 2: 4.5

CESL Asia investment in Monte Pasto

	CESL Asia
Who	• CESL Asia is a Macanese group (since 1987), founded and led by António Trindade, when part of the Somague (Portuguese construction company) team in Asia decided to *go solo*; Has assets of USD +80Mn, sales of USD 65Mn and +450 employees • Mr. Dominic Sio, key shareholder, is the Macau Representative to the National People's Congress of the PRC • Provides development, architectural and engineering services of technical, energy and industrial facilities • Monte Pasto is a 3.700ha pasture property (over 12K animals), which is the largest producer of beef in Portugal • The bankruptcy under former shareholder SAPJU drove it to the hands of PME Capital growth a Novo Banco Fund • In 2019, sold EUR 18Mn and had a negative EBITDA of EUR -1.3Mn
Deal	• CESL Asia, through its subsidiaries Focus Platform e Focus Agriculture acquired 100% of Monte Pasto for EUR 37.5Mn • The objective is to expand the production (e.g., olives and almonds) and to open the Asian market (EUR 5Mn sales in 2022)
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Irrelevant (1) •Government ownership: Private (2) Despite the political relationship, this investment has a strictly private rationale •Level of Control: absolute (3) •Deal size: Small (1) •Government touting: No (1) •Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: •Version 1: 3 •Version 2: 3

Real estate investments related to the Golden Visa Program

	Real Estate related to the Golden Visas
Who	• In 2012, the government created a resident permit for investment, which granted residency, visa exemption within the Schengen area and family reunification, to non-EU citizens making investments in Portugal that fit one of the criteria: Capital transfer with a value equal to or above 1 million Euros; The creation of, at least, 10 job positions; The purchase of real estate property with a value equal to or above 500 thousand Euros; Capital transfer of the amount of 350 thousand Euros, or higher, for the acquisition of units of investment funds… among others • Officially, the Chinese state was never very supportive of the program, which, alongside other programs around the globe, was an enabler of Chinese capital flight; Nevertheless, over 3000 Chinese citizens were able to access the program
Deals	• The program was a major success, and the investment in real estate projects were by far the most commonly used (namely in Lisbon and Porto), and China was by far the most frequent origin of the investment summing EUR 2.7Bn from 2013 until 2019: (243Mn in 2013, 745Mn in 2014, 348Mn in 2015, 524Mn in 2016, 335Mn in 2017, 288Mn in 2018, and 235Mn in 2019
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Irrelevant (1) •Government ownership: Private (1) •Level of Control: absolute (3) •Deal size: Large amount in total (3), despite being very fragmented •Government touting: No (1) •Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: •Version 1: 4 •Version 2: 4

Kin Long investment in CIFIAL

	Guangdong Kin Long Hardware Products (Kin Long) investment in CIFIAL
Who	• Kin Long was established in 2003 and is a company offering services in terms of design and research, manufacturing and sales of construction and building accessories products (+20K different products) • Has 13K employees and 600 sales branches, serving over 100 countries • Founded in 1904, CIFIAL the producer of faucets and sanitation hardware exporting most of its inventory, with the UK and the USA as key markets (e.g., in the 90s was the provider of the White House) • It was not able to survive the increased competition from China and was intervened by ECS turnaround Fund in 2013, which acquired 90% of the shares (10% remained with the Marques family)
Deal	• In 2019, Kin Long acquired 100% of the Cifial for an undisclosed amount; Judging from its EUR 600K EBITDA and EUR 3Mn debt the transaction may be presumed to have cost EUR ~2Mn to Kin Long
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Irrelevant (1) •Government ownership: Private (1) •Level of Control: absolute (3) •Deal size: Small (1) •Government touting: No (1) •Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: •Version 1: 2 •Version 2: 2

CSCEC co-investment with Teixeira Duarte

	China State Construction Engineering Corporation (CSCEC) investment in/with Teixeira Duarte
Who	• Founded in 1975, CSCEC, which is an SOE directly managed by SASAC, is the largest construction company in the world (2019 sales of EUR 50Bn) - it is the Chinese company which built the two hospitals in Wuhan in the span of 10 to 12 days • In 2020, the US released the list of companies with ties to the PLA operating in the USA - CSCEC was included on the list • Teixeira Duarte is one of the largest and historical construction companies in Portugal (EBITDA 36Mn) with global presence • Teixeira Duarte has long owned a subsidiary ("TDE") which owns a land plot in Oeiras, accounted in the books for 19Mn
Deal	• Teixeira Duarte and CSCEC have signed a joint venture for the development of the real estate of TDE. In order to do so, CSCEC paid (in 2019) EUR 31.1Mn in exchange for 50% of TDE. This meant an immediate EUR 22Mn gain for Teixeira Duarte • The project will include residential commercial and office buildings and a large green park
Features relevant for PIP	• For PIP purposes this transaction has the following attributes: •Sensitiveness: Irrelevant (1) •Government ownership: SOE (4) •Level of Control: control (2) •Deal size: Small (1) •Government touting: No (1) •Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: •Version 1: 4 •Version 2: 4

COFDI in Portuguese soccer teams

	COFDI in 9 soccer teams
Who	• There have been at least 9 Chinese investments in small Portuguese soccer teams. According to sources, there are 3 main motivations: (1) Attempt to arbitrage between player values in China and in the West, by launching Chinese players in Europe and bring them back; (2) selling weak players to China for a high price as a means to take money out of the country; (3) fix results to make money on gambling websites • The teams which have been invested by Chinese investors are the following: (1) Gondomar Sport Club is owned by the Chinese foundation Hope Sun Star, which owned 18 Chinese players (2) Mr. Kuong Chun Long, born in Fujian, but present in Portugal for 20 years, bought 90% of Cova da Piedade (after Mafra and Loures) (3) Wei Zhao and Hongmin Wang acquired 70% of Desportivo das Aves in 2015 for EUR 700K (4) Iberia Univeral acquired 70% of Sintrense; Liang Zhan is the president. This was sold to Dr. Diogo da Silveira in 2020 (5) 80% of Tondela was acquired by David Belenguer in representation of Hope group (from Jiang Lizhanf) which owns 99% of Granada, 30% of Parma, controls 2 chinese teams (Chongqing Lifan and Shanghai Sunfun), and some stakes in NBA teams (6) In 2013, Anping Football Club Limited, owned by Mao Xiaodong, acquired 70% of Atlético, and led it to a result fixing scandal (7), (8) and (9) Qi Chen has owned Pinhalnovense and Torreense, but left Torreense in 2019; He has also founded Oriental Dragon FC
Features relevant for PIP	• For PIP purposes these transactions have the following attributes (considered together as one): • Sensitiveness: Irrelevant (1) • Government ownership: private (1) • Level of Control: absolute (3) • Deal size: Small (1) • Government touting: No (1) • Concertation with other COFDI: No (1)
PIP	• Therefore, the estimated PIP is: • Version 1: 2 • Version 2: 2

2 failed industrial greenfield projects

	Wuhan	Zhejiang investment alongside Metal rolo
Who & project	• Founded in 2002, Wuhan Zhongye group is a Chinese manufacturer of steel smelting and molding equipment • In 2011 it initiated a small operation in Portugal and announced the intension to invest EUR 27Mn in a factory of advanced products • The first EUR 12Mn were invested and the project was under development when in 2015 the company suffered financial problems in China and was not able to continue the project • The local partner was Carlos Teixeira, from Cheto corporation, who confirms the project was left unfinished after the Chinese counterpart failed its financial obligations • The Chinese steel industry prospered for decades and hit a situation of overcapacity and the state had to intervene and regulate a downsizing	• Zhejiang Huadong Steel Group main products are pre-painted galvanized steel coils and hot dipped galvanized steel coils • It is a HK registered and majority owned by SAFE, the central regulator responsible for managing China's foreign reserves • In 2013, 360 steel materials was constituted and EUR 4Mn equity were injected, followed by EUR 4Mn in 2014 and EUR 5Mn in 2015, the Portuguese partner was Metal Rolo • The project did not go ahead with the Chinese partners and was eventually picked up by the Spanish steel distributor Network Steel Resources (60%), while Metal Rolo maintained its share • The company is now called Aveiro coated solutions, which is one of Network Steel's brands
Features relevant for PIP	• For PIP, this transactions would have had the following attributes: • Sensitiveness: Irrelevant (1) • Government ownership: Private (1) • Level of ownership: Control (2) • Deal size: small (1) • Government touting: Yes (1) • Concertation with other COFDI: Potential conflict (1)	• For PIP, this transactions would have had the following attributes: • Sensitiveness: Irrelevant (1) • Government ownership: SOE (4) • Level of ownership: Control (2) • Deal size: small (1) • Government touting: Yes (1) • Concertation with other COFDI: Potential conflict (1)
PIP	• Therefore, the estimated PIP would have been: • Version 1 : 1 • Version 2: 1	• Therefore, the estimated PIP would have been: • Version 1 : 4 • Version 2: 4

Sources: Sabi database, company websites, news article, interview to Mr. Carlos Teixeira

Appendix B – Interview summaries – one pagers

Below is an illustration of the interview guide used in the interviews.

1) Overall, how supportive are you of COFDI in Portugal?
2) What role do you believe that Portugal, the EU, and China play in each other's foreign policy?
3) How does COFDI in Europe/Portugal fit into the EU-Portugal relationship with China?
4) What is the role of Portugal in USA Foreign Policy, and how does the relationship between China and Portugal influence the Portugal-USA relationship? How should Portugal and the EU balance their relationship with China with their relationship with the USA?
5) This is a set of questions regarding motivations of COFDI in Europe and in Portugal:
    a. What were the main motivations of COFDI in Portugal?
    b. Do political motivations influence meaningfully any COFDI in Portugal?
6) What makes COFDI better or worse than FDI from other countries?
7) This set of questions aims to understand which Chinese investments may have higher PIP and what factors, beyond COFDI, impact the aggregate PIP in each country:
    a. Which characteristics dramatically increase the PIP of any particular investment?
        I. Size of the transaction
        II. Type of sector (media vs. critical infrastructure vs. other)
        III. Level of executive control over the company
        IV. Market structure (dominant position vs. fragmented market)
        V. Type of investor (SWF vs. SOE vs. Private)
        VI. Other
    b. Does the (simultaneous) FDI from other global powers impact the aggregate PIP of COFDI in each country?
8) This is a set of questions regarding hypothetical political leverage held by China in Portugal:
        a. Does China hold political leverage over the Portuguese Government? How does it work in practice (none vs. basic goodwill from strategic engagement vs. active interest groups vs. subversive influence vs. coercive influence)?
        b. What are the most important influence levers? (FDI vs. trade vs. Government debt vs. financial contribution to political parties vs. media ownership vs. others)
        c. Are you aware of any concrete attempt from China to coerce or subvert Portugal or any other EU member state?

d. What do you think it should be the EU's position regarding HR issues in China?
e. Would you oppose the investment of a Chinese SOE in the Port of Sines? In Lages?

9) This is a set of questions about the COFDI case where you were involved (when applicable):
   a. Overall, are you satisfied with the interaction with Chinese stakeholders? Why?
   b. What were the main motivations for this Chinese investor to invest in this target?
   c. Are you aware of any political motivations? Are you aware of any pressure by the CCP to execute this specific investment?
   d. Can this investment be used for political leverage over the Portuguese Government? If yes, please elaborate on how it works, and which economic actors can be influenced and how.
   e. What type of governance control does the Chinese investor hold?

The interview guide for President Cavaco Silva was adjusted to focus on his diplomatic experience. That input has already been mentioned in Subsection 3.d.iv.

The next 42 pages summarize the contributions from each interviewee.

Professor Abel Mateus is a prominent economist and regulator. He was senior economist at the WB, Board member of *Banco de Portugal* and the Bank for Reconstruction and Development, and President of the Portuguese Competition authority.

Overall, he is not supportive of COFDI. He believes the main driver of COFDI is the acquisition of know-how, together with geopolitical considerations, which he fears in the long run.

> "We want to be aligned with who? With NATO, with the EU or with China? That is where we have to align our interests and not with China, which gives us pocket money compared to what we received from the EU. There is a lack of perspective".

He points out that well-established academic knowledge of FDI, independently from China, opposes FDI in dominant positions, because the rents extracted will be value destroying for the economy in the medium run. Dominant positions are always a source of concern but in the case of foreign ownership they are exacerbated because the profits are drained out.

As a rising power with liquidity, China is craving for know-how "there are, obviously, a set of motivations, namely of profitability, geopolitics and, very important, the extraction of know-how", and Portugal revealed itself more open to give know-how away than other EU peers. Contrary to FDI from mature economies, COFDI does not bring new know-how itself.

He thinks that economic power above a certain level provides political influence (even if that is not the main driver of COFDI) and that Portugal should rethink the long-term consequences of aligning with China.

Regarding regulation in Portugal, he believes that the regulators are captured by the governments which appoint them.

Professor Cavaco Silva has been PM and President of Portugal. He was the only Portuguese politician which interacted with the last four presidents of China: Xi Jinping, Hu Jintao, Jiang Zemin, and Zhao Ziyang. The Chinese officials call him "the old friend of China".

His interview focused on the Macau transition process and his diplomatic experience with China. In the transition process, the Portuguese negotiation power arose from China wanting to have a negotiated outcome, which would be diligently respected, despite the asymmetrical sizes. From his point of view, the Portuguese priorities were: leaving the last piece of overseas presence with honor (contrasting with the chaotic exit from the colonies in 1970s); the stability and development of Macau; the welfare and the rights of the Macau residents; cultural preservations (e.g., Macau bishop to be nominated by the Vatican) and setting the base for a fruitful economic relationship thereafter.

In a brief reference to the core topic of this thesis the President has shared that, as an economist, he is well aware of the weaknesses of the Portuguese economy, namely the lack of capital and the external deficit. This is the main reason why "our country is interested in attracting FDI". From his perspective, China sees Portugal as an extraordinary case of mutual respect and Portugal also helps China in its dialogue with the EU: "at the time when the large EU countries blocked COFDI, Portugal did not discriminate China. And they do not forget that… China considered Portugal a partner". He believes that China regards the EU as a balancing actor in contrast to the recent troubled communication with the USA "I think China defends the EU a lot. Even to have an interlocutor that makes the balance with the USA".

Portugal shall define its limits to FDI: "In FDI, it is important to check who is behind it, if it is the private sector or if it is a political power... so it is important to have boundaries". He is afraid that Portugal will not be credible economically if it does not have 4-5 large Portuguese companies in its own stock market, majority owned locally.

Dr. António Costa has been the PM of Portugal since 2015, reason why his opinion is perhaps the most important among all stakeholders. He benefits from the fact that among his closest group of advisers, there are many who have been in the Macau transition office and have earned first-hand insights since then (e.g., Dr. Eduardo Cabrita, Dr. Pedro Siza Vieira, Dr. Diogo Lacerda Machado). He values the presence of COFDI since "it is an investment that has been extremely respectful of the Portuguese State rules*".* He feels that he has "never seen them taking an initiative without letting us know first, and, whenever the issue is more sensitive, without asking our opinion".

From his perspective, China looks at Portugal as a way to access advanced technology (particularly in energy) but also "as a country that has a special relationship with several countries in geographic areas that are strategic to China, namely Africa and Brazil".

He does see a "big American concern about the Chinese presence in some strategic infrastructures" but thinks it is possible to maintain COFDI without undermining the relationship with the USA and the EU.

He considers that "there was clearly a political backing" of COFDI, although he does not believe that China will try to pull its weight in converting economic power into political influence: "our relationship has always been very positive. Obviously, this investment intensified the relations and the contacts".

Speaking about the privatizations, he says that "there were several companies in which the State's presence did not make sense*",* but he admits that he misses State influence over some critical sectors, such as the telecommunications sector.

Talking about specific investment cases, "REN was especially interesting for them, since REN managed the integration capacity of the different renewable energy sources*",* while EDP was mostly about learning advanced know-how in renewables. He adds that the capital injection in BCP was very important when it happened.

Mr. António Costa (ECO) is an influential economic journalist. He is chief editor and shareholder of ECO. Before, he was Chief Editor of Diário Económico.

He accepts the current stock of COFDI, but more would probably be too much, because it may undermine the balance among origins of investments in the country. If Portugal was not in the EU, he would oppose COFDI because of the political situation in China, the reality of freedom of speech and political liberties. He says that "we need their capital, but not at any price".

But there are merits to it

> "From our perspective, not everything is negative... on the innovation side, the capitalization side, and the markets that they open, including the Chinese market. What I think we have to ensure, either in the regulation or in the contracts, is that they comply to the Portuguese law and the market legislation*".*

Portugal is very important to China because it is, among the EU members, one of the few allowing China to acquire important stakes in strategic assets. China is important to Portugal because it provides the much-needed capital and increases the profile of Portugal in foreign policy. He mentions that the Chinese are willing to pay higher valuations because they have a long-term perspective and value strategic considerations. From his perspective, there is a difference between SOEs and private investors.

> "I think there is a difference between public and private Chinese investment. The Chinese State's investment is clearly one of political influence… The private, I would say, has a bigger weight of business, this has to do with their culture".

He is afraid of political influence and in the current government there is even more goodwill towards China because many stakeholders have links to Macau (Dr. Siza Vieira, Dr. Cabrita, Dr. Lacerda Machado, Dr. Jorge Coelho, Dr. António Vitorino). "I would say that they do not need to be negatively influenced, they are sensitive and available to COFDI, even for personal and historical reasons". The official "position goes beyond money. I think the Minister regards that it is of our national strategic interest to have this connection with China".

He believes that CTG does not control EDP, otherwise António Mexia would not be CEO.

Dr. António Pires de Lima is a noticeable individual in Portugal due to his business and political achievements, which include being Minister of the Economy, CEO of UNICER, President of the National Council of CDS-PP and more recently CEO of BRISA.

He supports COFDI: "I am favorable to it. Portugal cannot afford to have prejudices in relation to FDI and would not have anything to gain from having prejudice against China". The interdependence "between Portugal and China is good for Portugal. It gives us a relevance that we would not otherwise have in Europe". Also, the Portuguese companies which are able to enter the Chinese market increase scale significantly. COFDI compares well with Spanish FDI:

> "The Chinese have been maintaining qualified Portuguese managers running their invested companies. Differently from Spanish investments, we do not see those Portuguese companies becoming irrelevant in their Groups. Sometimes, in the Spanish examples the new management team hardly speaks Portuguese."

China is also very important to the EU: "the political, economic and commercial relationships with China are critical for Europe. Specially in a moment of increasing difficulties in the relationship between the EU and USA…a tight relationship with China is important to the EU*"*. Despite the multiple benefits coming from COFDI, he acknowledges that in China "the economic power is understood as political power, and I do not dissociate the COFDI". Inevitably, "there is a goodwill in the political relationship created by this economical relationship". At the same time, "there are no free lunches, when the time comes and China needs to exercise the influence that it acquired in Portugal, they will use it". This is already visible: "The ownership of EDP, REN, Fidelidade, BCP provides the Chinese State with weight, as it can be seen by the friendly stance of the current and the previous governments".

Professor Augusto Santos Silva is a sociologist and a politician, who has been MFA since 2015. Before, he served as Minister of Education, Minister of Culture, Minister of Parliamentary Affairs and Minister of Defense.

The depth of the relationship between Portugal and China is historical

> "The Portugal-China relation exists within the EU and respects the differences between both countries in terms of geopolitical insertions and their consequences with regard to neighbouring countries, affinities and alliances. Portugal is a part of NATO and China knows it well. But one thing is clear: Portugal is historically close to China in a way that few of China's European and Western allies are*"*

Moreover, "If managed abiding by the principles of equality, differentiation and mutual respect, this inevitable relation with China can be very beneficial*"*. He cannot "anticipate any risk of becoming dependent... Portugal neither is in debt with China, nor negotiates any initiative with this country that implies the transfer of ownership or control over public infrastructures or the exercise of corporate capacity, namely in the regulated sectors, outside of the Portuguese and EU laws". Portugal welcomes COFDI but "the time for the acquisition of interests in existing companies is long gone; now, growth plans for those companies and greenfield investments are more important". Moreover, China needs to respect the "EU standards, observing all national security, fair competition, and environmental and financial sustainability requirements*"*.

From the EU perspective, the relationship is "complex, but necessary". He explains the complexity with three main points: economic competition, security requirements in critical infrastructures, and HR progress.

He rebuts the idea that the country is partnering up with China "behind the EU's back. It's precisely the opposite. During the adjustment program (2011-2014), we were a relevant Chinese investment destination in Europe; now, China's interests mostly rely on the energy, banking, insurance and health industries, and have observed the law and contributed to the Portuguese economy*"*.

Dr. Bernardo Mendia was interviewed for being President of the Portugal-Honk Kong Chamber of Commerce. He has held senior positions in multiple international institutions associated with the promotion of FDI from/to China. Since 2021, he is the new Secretary General of the Portugal-China Chamber of Commerce.

From his perspective, COFDI is very important because "it represents a lot of money that can be invested in the Portuguese economy and Portugal needs that money from abroad".

He does not see a big difference between COFDI and investment from Spain, who took over the banking sector, "they even rebranded some banks and transformed them into subsidiaries, and did not keep the companies' identity which, at least on that aspect, the Chinese did".

He believes that Portugal is important to China due to their "interest in the human capital, in the know-how capital. They came to learn, to acquire best practices, and maybe they will bring best practices as well". Also, as an entry door to the EU and in providing diplomatic ability close to "the Community of the CPLP, and that is relevant at the UN level". He shares that the Chinese investors who he knows well are very satisfied with their investments in Portugal, namely Fosun, CTG and CSGC.

He acknowledges some political motivations: "Yes, maybe there was that political motivation in geostrategy, for sure…. otherwise, they would not come". Regarding political influence, he notes the Portuguese President and the Portuguese PM "will not be influenced by anything of that kind or stop mentioning the HR. Actually, they continue doing it: every time they go to China, they insist on referring that issue". So, he does not see any political influence from the Chinese side and refers that the network and connections which were created are very positive and should be stressed.

Dr. Mendia believes that Portugal did not privatize too much. His main preference is that we have zero intervention of the State in our economy and that the State should focus on regulating the economic activity.

Dr. Carlos Magno is a prominent journalist with a vast network across the political spectrum, providing him with a broad range of second-hand perspectives. The fact that he covered, as a journalist, the PM Cavaco Silva's visit to China to sign the transition agreement of Macau and his experience as president of ERC (media regulator) makes his viewpoint unique.

He believes that, due to Portugal's geographical distance, COFDI "is never too much. Our irrelevance is our main advantage, because... we are, from the geostrategic point of view, in a total periphery". The critical question to anticipate is how the debate about COFDI will play out in the media and the political debate: "Will it be instrumentalized in domestic politics"?

He considers that Portugal is important to China and China looks at Portugal in the EU as the Portuguese looked at Macau in Asia, 500 years ago. China believes that the Portuguese are respectful and will be instrumental in the EU, and Africa:

> "I realized that the Chinese want to be in Portugal. They want to be here due to investment and strategic reasons. But, at the same time, because they think they can establish a good relationship with the Portuguese, different from the one they have with other European countries, namely the English and the Spanish".

From his point of view, the Chinese are focused on growing economically in Portugal but mostly as a means to create Portuguese branding and fronting to their own businesses: "at this point, their interest in Portugal is to leverage their businesses, based on a European branding". In the process, they will use Portuguese businessmen in those plays because they provide more credibility, but also because they know how to operate the market.

Regarding the media sector, he believes Kevin Ho's investment in Global media was an answer to a direct request for support. Priza would not have accepted to sell TVI to Chinese owners.

From the geostrategic standpoint, he believes that it is too soon to foresee what will be the implications of the Chinese rise to the World Order, to the EU and to Portugal in specific: "it is way too soon to assess how this will play out".

Dr. Carlos Monjardino has a long track record of interaction with China in both the political and the economic domains. He has been the president of Fundação Oriente (since 1994), Fundação Mário Soares and Fundação Stanley Ho. Besides that, he was the Substitute Governor of Macau from 1986 to 1987 and was in the Board of several companies (BPG, Petrogal, Generg, TVI and Companhia de Seguros Sagres).

Overall, he tends to "accept the Chinese as good investors, they stay for a long time, they are not very speculative".

He believes that Portugal is important to China due to the length of the relationship and the fact that the Chinese know Portugal: "They think that just because we have a relationship, know-how of China and they have of Portugal, due to Macau, that is very important for them. We are 'the old friends'."

From his perspective, China is a good *threat card* in the EU and vs. the USA, increasing the relevance of Portugal "is it a risk? No. It is good. Because the EU also realized that we have a privileged relationship with China and that is clearly beneficial for us".

According to him, the Chinese had a strategic rational to invest in Portugal. On the contrary, Portugal had no strategic vision in attracting the Chinese, since the "only goal was cashing in". He mentions that "anyone understands that when someone has a lot of economic power, they eventually have political power". He thinks that happened in Portugal as well, although in an indirect manner "because the people they hire to represent them here are normally influential people who eventually influence political power on their behalf".

From his point of view, he would "rather not privatize so much, keep golden shares, etc.". And looking forward, he considers that the Chinese "need Sines in purely commercial terms. I am convinced that they will not put their submarines or aircraft carriers, they cannot do it. But obviously we cannot facilitate too much the conditions".

Dr. Lacerda Machado's experience with China dates to the Macau transition office in 1988. He is Board member at Geocapital (which has business dealings with China), is part of the Forum Macau and is a consultant to the PM in highly complex projects.

Portugal, who lacks private capital, should use Chinese capital to "maintain the decision centres in the country". This possibility arises because of the historical relationship between the countries, China's cash liquidity, their interest to work together in Africa, and their willingness to keep local management in the invested companies: "The relationship with Portugal is completely different and China truly values it… they are welcomed, mostly because they came when no one else invested, as well as the peculiarity that they invested without control".

For him, Portugal has long wasted the opportunity to help China in the CPLP which "are not strategic to China, they are vital, which is much more than that." China also appreciates Portugal's openness to let them enter industries which are closed to them elsewhere. Dr. Lacerda Machado says that 10 years ago China started using "supposedly" private players to acquire important stakes overseas using market-looking agents

> "all those groups had a public bank behind pumping money. This is how, suddenly, Anbang, Fosun, CEFC, HNA and others appeared. These "supposedly", private groups went out of track on their shopping spree and had to be stopped. FOSUN was deemed 'too big in Portugal to fail' and allowed to continue, but less exuberantly"

When the Chinese own minority stakes, they tend to be unable to pull their weight. CTG was disrespected and misled at EDP from day one. The Americans are actively involved in balancing out COFDI: "the takeover to EDP felt in a final blow when Elliot entered the game. This is an institution which does not invest just for maximizing the returns…".

CSGC appreciates REN's bond-like appeal, but the investment was driven by the interest in Africa, namely Mozambique. Despite appreciating COFDI, he thinks Portugal should not have alienated several strategic assets during Troika: "I wonder why EDP is privatized. The public debt needle did not move, and the Portuguese state lost a strategic position".

Professor Eurico Brilhante Dias is the Secretary of State of Internationalization. Moreover, he has been University Professor (e.g., at ISCTE) since 2000, a Board member of AICEP and a member of the Parliament.

He is neutral towards COFDI: "I am supportive of COFDI, as I am supportive of FDI from Spain, France, Germany, USA, etc.".

Speaking about the relevance of Portugal to China, he mentions that "we are a very important partner for China in their learning process and they value us for that". From his point of view, the assets acquired by the Chinese

> "are good to acquire know-how, to access new technology and to open new markets – it is clear that EDP is a large renewables operator in the USA and beyond. Assets in EUR are also interesting from the strategic point of view… it has an interesting dimension of cooperation with third countries – it is an investment in Portugal but with links to Latam, the USA, the EU, particularly attractive to who has the patience and the time to wait for better days".

Regarding the possibility of China converting economic power into political influence, his answer is "No. Not necessarily". Inevitably, someone "who owns assets always has some influence, but their influence resides on daily matters". According to him,

> "It would be different if we were on a level of dependence where the sender country owned a disproportionate share of the investments in our country – but China is not even a holder of Portuguese public debt. I think that is not a question".

He disagreed with some of the privatizations. He is particularly critical of the REN case. He considers that "it was a cash-in opportunity and we gave up the rent in exchange for the cash. But it does not make much sense". He wonders what drives a country to "make a concession on its high-voltage energy transmission network. I do not understand why we did it. It is an extremely regulated business and without competition".

Professor Fernanda Ilhéu is the President of the *Associação dos Amigos da Rota da Seda* (Association of the Friends of the Silk Road). Moreover, she is a Professor (at ISEG) of strategic marketing and operational marketing, specialist in the internationalization of Portuguese companies to the Chinese market.

She has an economic and business perspective in relation to COFDI and believes that the discussion about it has been biased by IR towards a poetical and theoretical analysis which does not fit well with China's pragmatism. She is very supportive of COFDI, as well as any other FDI "as long as it adds value" to Portugal. COFDI "brings a dimension that the Spanish could never bring. COFDI is not competitive like the Spanish, it is complementary instead."

She considers that Portugal is important to China for several reasons:

> "First, the historical relationship... Then, Portugal is not threatening, and is not competitive. It has several hospitality advantages. On the other hand, from Portugal, it is possible to establish connections to other parts of the world. Not only in Europe, but also to Latin America and Africa*"*.

From her perspective, China is important to Portugal because it can provide a scale which is not possible with other partners. Particularly in Africa, Portugal should try to partner with China to take advantage of the complementarities. She mentions that COFDI has political motivations because everything is political in China but the return on the investment is also very important:

> "It has. Everything that happens in China is political, is coordinated, and is known… At same point, when the world faced the crisis (the EU, and the USA), China realized that it had the capacity to come and acquire assets that were very cheap, so, the political order was 'let's go shopping… there are good opportunities… in the west'."

This proximity to China gives "Portugal visibility and negotiation capacity in the EU, and with the USA. Today, we are better positioned to negotiate with them".

Mr. Fernando Ulrich is an important banker in Portugal and Spain. He was president of BPI and BFA, very large banks in Portugal and in Angola. In the 1980s, he was chief of staff of the finance minister. He has a unique perspective because he has been an interested and informed observer of COFDI without direct contact.

His main feeling about China is the acknowledgement of the sheer size, which is overwhelming, even fearful: "You are not familiar, you see something gigantic growing at a fast pace, my first reaction, maybe not very enlightened, is fear". Back in 2013, he was distant from the topic but against the sales to Chinese investors. Seven years later, he admits that probably it was a good idea: "Having said in 2013 that they should not sell those 25% of EDP to the Chinese, maybe now in 2019, I might say that they did well, since nothing catastrophic happened". He considers that the system proved capable of rejecting the 100% takeover of EDP. Perhaps it is too early to tell the ultimate implications, "but so far so good".

From his perspective, Portugal is not very relevant, but the history of the relationship, through Macau, is valuable because the other European countries do not have this advantage,

> "…we have a special relationship with China due to Macau. I do not know how special it is, but it is somehow. The French don't have it, the Germans don't have it, the Spanish don't have it, so there is a differentiating element and I agree that there must be a strategy to leverage the good relationship with China".

Standalone, Portugal should probably leverage the access to China in its favor, but if he was in charge of the EU, he would have a containment strategy versus China and Russia.

Mr. Ulrich would always prefer European investments to COFDI: "I would have preferred European buyers to the banks and the insurance companies".

He believes that the mere fact that the Chinese investors own large Portuguese companies where very reputable and capable Portuguese stakeholders work, creates the possibility for better understanding of their interests, which in the end results in goodwill. If CTG would have won the takeover bid over EDP, the scenario would become threatening.

Dra. Filipa Alarcão provides a unique contribution due to her hands-on experience as chief of staff of the Secretary of State of Treasury Isabel Castelo Branco between September 2013 and November 2015, during the Troika intervention. She worked directly in the privatizations of EGF, TAP, CP carga and the 2nd stage of REN's privatization. Before, she worked in capital markets for BPI and is now an investment manager for Dr. Sérgio Monteiro and Dr. António Pires the Lima's investment fund (Horizon).

She is "very supportive" of COFDI, which compares well it FDI from other origins:

> "There tends to be a big difference in terms of governance because, contrary to European investors, the Chinese do not take too many Board seats and generally trust local people for the management team. I see this difference as an advantage to Portugal, and I also see that this makes sense".

From her perspective, Portugal is "not strategic to China because we are too small. We may be in a mild way, relevant to them as an entry door to the EU. But very mild*"*. Also, she acknowledges that "the size of our economy and our limited political power made their presence in Portugal somehow irrelevant to them*"*.

COFDI motivations are "essentially economical*"*. However, she does not believe that

> "they hold significant leverage over the Portuguese government. In some cases, they may align with Chinese demands, just like many times the government doesn't. Our government or the current one. China is an important partner, with whom we maintain a good relationship for as long as that is in our interest".

She shares the difficulty of the privatization processes, which require to account for so many future scenarios to protect the country's interests. First, there were some generic safeguards "there is a decree-law defining which are the strategic assets. It is a weak decree-law but exists and perhaps could be improved". Beyond that "we did our best in doing good concession contracts and maintaining good regulatory bandwidth. People may point the finger at the contracts and complain about x and y, but that is true regarding any contract. They are never perfect in everyone's eyes".

Dr. Jorge Magalhães Correia is a notable Portuguese executive. Among other roles, he has been Chairman and CEO of Fidelidade, Board member of REN, Chairman of Luz Saúde, Board member of BCP and Professor of Law at Universidade de Lisboa.

He is the trusted representative of Fosun in Portugal and is very supportive of COFDI in general. Questioned about why COFDI has had a smooth entrance in the Portuguese economy he replies that the critical factor is that the Chinese "investors like availability, transparency, and flexibility or adaptation and those are characteristics that we tend to have". On the Portuguese side, China brings the capital, but also respect for local management and local employees "I can assure you that after 5 years of working with Fosun and with the Chinese investors (they are very hands on), I have never heard about reducing personnel".

Regarding the relevance of Portugal to China, he believes that Portugal is not special, it just happens that the country provided good opportunities to China

> "A Chinese investor invests in Portugal, which was in trouble because no one invested here in 2014, but also invests in Slovenia, Indonesia… from their perspective, the world is flat. The opportunities are what counts".

He refutes the idea that "the Chinese want to steel our technology" because*,* "they do not need our technology for anything*"*. As a matter of fact: "only those who have never visited China think that way". At the same time, some privatizations may have been too much. The critical case for him resides in ANA's concession to Vinci:

> "Insurance is not a strategic sector… it is not like EDP or REN. As a citizen, about TAP, any company flies here. What seems critical is the infrastructure, what can be discussed is ANA, is the airports infrastructure, since it is a strategic asset".

He says "REN is well, CSGC really supports REN. I would even say that since the failed takeover process (of EDP), CSGC has become even more committed to REN's development". About Fosun, he mentions that "Fidelidade also acquired a stake in Luz Saúde. We have a purely financial interest in REN, 5% of capital. It is an investment that we like. In good years it yields 7%, in bad years it yields 5%. It is a very stable business which never goes wrong*"*.

Ambassador José Augusto Duarte is the Portuguese Ambassador in China. He was a diplomatic advisor to the President and served in many other diplomatic missions (Mozambique, Spain, France, USA).

For him, Portugal needs to take advantage of the historical proximity with China: "following China closely is following closely the evolution of the world. Economics are important, but it is much more than that. And Portugal needs to maintain a bilateral relation with China and keep track of what they are doing". The long-held relation with China must be preserved:

> "Portugal never participated in a military conflict against China, even when China was defeated twice by a coalition of European Powers. Portugal does not confuse friends with allies, but also does not presume as enemies the enemies of our friends. We do not need to import the conflicts of others. Off course we share fundamental values with the Americans that we do not share with the Chinese, but that is not a motive for anything more than acknowledging the differences, and we have always lived well with the differences".

He believes that COFDI should not be discriminated against FDI from other origins: "no one should be discriminated according to its origins, or ethnicity or religion… so long as they respect the market rules". Moreover, "protectionism that privileges only Europeans is not necessarily the most virtuous alternative… we need to defend our interests and not behave as pawns in the geopolitical chessboard".

For China, "the relevance of Portugal is proportional to the COFDI in Portugal in comparison to other countries. Portugal is between 8th and 10th place in COFDI in the EU". The EU is also important for China "more so in the context of the Trade War between the USA and China. The EU gains an increasing role as a balancing power in that context, both economically and politically. The current obsession is the USA".

Inevitably, "there is always a political filter to these investments", but we should not have "an egocentric view that China is very focused on Portugal", because Portugal does not attract more FDI than its EU peers.

Dr. José Luís Arnaut is a prominent lawyer and politician, twice minister of Portugal, and holds important positions in privatized companies, such as REN (Board member) and ANA (Chairman of the Board). He believes that all FDI is beneficial and desirable in Portugal and approves diversification of sources. However, he believes that EU FDI should have different rules and restrictions than non-EU FDI: "I think it is important to have boundaries for the strategic sectors, with capital and transparency rules different for countries which do not belong to the EU". Dr. Arnaut thinks that the Chinese have seen in Portugal a door to enter in the EU and other geographies where the access is difficult: "what I consider relevant is that they (Chinese) were able to access important sectors in Portugal, such as energy and insurance".

He believes that Portugal needs to think about COFDI differently from EU FDI and that Portugal should defend its economic interests vs. China within the scope of the EU "We have to understand that we are in the EU and defend our interests within the EU framework". He considers that the problem of COFDI is centred in the lack of reciprocity and does not like to see Portugal pursuing its own agenda individually: "I think this idea of the individual countries, like Portugal, acting standalone does not make sense".

Dr. Arnaut describes CSGC as a large and powerful company, while CTG is a small regional company which manages a big dam, and it is EDP which gives strategic relevance to CTG:

> "CSGC is a big Chinese company with significant political power and with a colossal dimension. CTG is the manager of a big dam which has a foreign investment (EDP) and is important for them, since otherwise they would not exist strategically*".*

He perceives Fosun as a respectful and successful company, which is a sort of private equity Fund: "Fosun, a private equity soit disant, present in Fidelidade, BCP and in Luz Saúde, is a very respectful, competitive and successful company".

Dr. José Manuel Durão Barroso is a very influential center-right politician. He was President of the EC, PM of Portugal, and is Chairman of Goldman Sachs International.

He sees the rise of China as central to the world order: "China's growth is the biggest geopolitical and geoeconomic phenomenon of the last three decades".

He appreciates COFDI in the EU if China accepts a logic of reciprocity, which includes limitations on a dual usage technology and other military considerations: "Yes to COFDI, but, if possible, in a level playing field, meaning with reciprocity principles". He considers that China and the EU are important to each other due to the level of economic integration, but also for political reasons, and the balancing of the global order.

Portugal is not relevant per se, but because it is a member of the EU: "Portugal is relevant, not due to the dimension of its market, but precisely because Portugal belongs to the EU". Portugal should welcome COFDI if it remains proportionate in relative terms compared to other origins.

He does not see how COFDI is a threat and points out that the risk tends to be higher in closer proximity (i.e., Spain): "I do not consider that COFDI represents any threat to the national sovereignty. I do not see how it represents a bigger threat than any other FDI, which is closer to us geographically".

He believes it is legitimate to question if Portugal is already conditioned in its criticism to China "this happens either because there is a more moderate Portuguese position in order to avoid conflicts with stronger powers, or as result of an effective economic influence in the Portuguese political system? That is a legitimate question". Moving forward, the EU should pursue peaceful outcomes and avoid economics being contaminated by geopolitics:

> "an investment regime that moves forward to reciprocity and assumes with transparency that there is competition without confrontation. Because, speaking about the two biggest economic powers that have different political and ideological models, there is a risk that the commercial agreements are contaminated with geopolitical disagreements, which can threaten the regional or global peace."

Dr. José Miguel Júdice's reputation comes from the eclectic nature of his occupations which include having founded a leading Law Firm – PLMJ, being an international reference in Arbitrage, Assistant Law Professor, writer, President of the Bar Association of Portugal, member of the Superior Council of the Judiciary and an influential political commentator.

China's is not a strategy of Maritime Power, and instead a Middle Kingdom Strategy where Portugal is too far from the core. It has an EU Strategy, which is a Eurasian Strategy, and Portugal is merely a weak link within the EU, where China has an easy relationship and assets are cheap. Portugal is not cornerstone to China, but the Portuguese language can be, for economic reasons. Portugal has another "advantage" of giving away know-how because it does not have a state policy for what can and cannot be share. Regarding political motivations, "off course the Chinese investors will be subordinated to the Chinese strategic interests, because the Chinese logic is that everything depends on the Party". But he has a cynical view about this. In the USA, the big corporate are also very close to the state… same in France and in Germany. He believes that it does not matter too much who we allow to invest in Portugal, because on the bigger picture "the result is always the same, independently of the origin of the FDI…We are increasingly irrelevant". China is important to Portugal in the sense that it may give Portugal some autonomy from those "who rule over us" – it can be a small "threat card".

The political implications are "minimal, because we are not the lords of our system. We are a poor and peripherical country". The power in Portugal is very fragmented: some groups have veto power, but no one has enough power to condition the rules of the game. There is no economic group, nor union with such power, nor any political party with enough cohesion to do so. Many groups can condition but none can condition in absolute. Therefore, there is no point in buying influence in Portugal. And yet, global economics is not a zero-sum game and it is good to maintain some autonomy from abroad – if Sines Port is the largest deep-water Port in the EU than Sines is important. Even more than the national grid.

Dra. Lin Man was the first China born lawyer in Portugal, and the only one registered at the Portuguese Law Bar until 2018. She had her own office until 2013, which focused on serving the Chinese Community in Portugal. In 2013, she (re)joined PLMJ, one of the most reputable lawyer's offices in Portugal, where she has been involved in the majority of the COFDI transactions in Portugal. Overall, she is very supportive of COFDI: “It was a great opportunity for China, who wanted to invest in the EU and always had a good relationship with Portugal”. She believes that large investments from SOEs require approval from senior levels in China’s hierarchy, whereas private companies are left on their own, if they respect the EU law and the Chinese law: “Speaking about the private companies like Fosun, my perception is that as long as they comply with the Portuguese and the Chinese Law, they are not bothered”.

Portugal revealed itself as a target to COFDI in a moment when China was looking forward to making acquisitions overseas, to gain market access and know-how at affordable valuations.

She is aware of a myth that the Chinese people arriving in Portugal in the 90s were supported by the Chinese state as a master plan to promote Chinese products abroad. On the contrary, as she has witnessed in her own family, and from her clients, the true story was harder for the Chinese emigrants. Firstly, everyone came to work in a few Chinese restaurants, and then, with time, opened their own restaurants in new locations. In the 90s, there were in Portugal two programs for extraordinary regularizations of illegal immigrants and many Chinese came from other European countries to Portugal. Among those coming from more mature communities, were some entrepreneurs who had experience in trading Chinese products. These people opened some large warehouses which allowed the flourishing of Chinese retail stores. These businesses were not financed by the suppliers nor by the government. Instead, it was a tradition of mutual help, which allowed this people to finance their initial ventures.

The Chinese community does not believe that China is dominating the world “I do not think so, they do not feel that way, they do not think that the Chinese are controlling the world”.

Dr. Luis Castro Henriques is the President of AICEP (Investment Promotion Agency), so he is responsible for attracting IFDI. He has had multiple interactions with SASAC and all Chinese investors. Before, he was a McKinsey consultant and Economics Professor.

He is very supportive of COFDI, which compares well with EU FDI, with pros and cons balancing out. COFDI has the advantage of maintaining Portuguese management and the decision centres in Portugal.

He considers that Portugal is relevant for accessing the CPLP: "China wanted to work with Portugal due to the access to the EU, but also due to the access to the Portuguese-speaking African Countries". Portugal needs to try harder to be perceived as a good entry door to the EU. The increasing hostility from other EU peers to COFDI may help Portugal in that regard: "I think this is going well, and the fact that there is a lot of resistance in Europe, only helps us".

From his perspective, increasing economic integration increases the goodwill from each country towards the other, but there is no risk of China acquiring preponderance in the local politics:

> "We should have no doubt that the greater the economic interaction and the economic interdependence, the greater the goodwill in relation to the other… I think it would require such a large combination of factors which makes it unfeasible. Such risk does not exist".

Nevertheless, he would be in favor of limiting the total share of investment in the hands of a single investor in all EU countries.

He takes stock of the concerns that China is extracting know-how in the EU, but questions if there is really any know-how extracted from Portuguese companies which was not yet available in China (e.g., REN case).

Dr. Luís Cervantes is an experienced businessman in the insurance and banking sectors. His understanding of how the real economy works in practice provides visibility of how economic power can be played by political reasoning.

He considers that COFDI is welcomed because capital is needed: "there is a win-win scenario in order to play the globalization game, therefore, I am not hostile to this bilateral situation". Dr. Cervantes believes that Portugal needs to take advantage of the economic integration with China to exploit the expansion of Portuguese companies to China.

COFDI creates political influence, more in the sense of veto groups and ability to seat down with governments: "Yes, and when I say influence, I mean influence as the definition of the word, it does not command, I do not believe it reaches that point". In his opinion, coercive power is not possible because in democracies it would result in change of leaders.

He says that Portugal is relevant to China within the EU because the EU works in a logic of veto power, in which China needs a base of 6-7 countries with close proximity in order to be able to veto positions against its interests:

> "But, on China's side, there is also a clear interest, in other words, Portugal is a full-fledged member of the EU. The EU configuration is built upon vetoes for structural situations. Therefore, a country which can, in a hostile situation with China, block a decision hostile to China, is an important asset".

In this sense, large investments by SOEs in strategic sectors may generate political leverage to the Chinese State, in which case they increase the risk level.

China is relevant to Portugal as a small "threat card" to be played within the EU, which increases its relevance; China is also a potential venue for the growth of the Portuguese economy. He considers that COFDI tends to think long-term, without requesting full ownership and maintaining local management, and this contrasts with the practice of European investors. Fosun, shareholder of Fidelidade, maintained the local management and the large insurance company remained a responsible market leader.

Dr. Marques Mendes is a very prominent political analyst in Portugal. He was Deputy Minister to the PM, Minister for Parliamentary Affairs, President of the National Commission of PSD and President of Strategic Council of Abreu Advogados.

He appreciates COFDI for 5 reasons. First, the practical reason: "COFDI started in a time of crisis, with Troika, in a moment when we really needed to attract FDI because no one was investing here". The Chinese were almost alone in showing up with firepower. Second, the historical reason: the excellent political relationship between both countries: "Portugal is probably, within the EU, the country with the easiest, deepest and smoothest relationship with China". Third, "COFDI is strategic to Portugal because it has a long-term perspective", which provides more stability than EU FDI. COFDI tends to privilege local management and incorporates Portuguese knowledge, experience, and sensitivity. Fourth, the competition reason: Portugal has had FDI for several years (from the EU, and the USA), but did not have COFDI, which is good for diversification. Finally, there is the "opportunity" reason: "China is a gigantic market, which can be very important for our exports".

Regarding motivations, he considers that "COFDI arrived because an opportunity was provided… China regarded Portugal as an entry door to investments in the EU". It is a strategic move. It is a good rational of opportunity, while not being opportunistic in the negative sense. He does not see political motivations, only strategic ones. Portugal is not at risk of losing its sovereignty: "if the Chinese would want to have political influence, they would be buying media companies, which would be extremely cheap for their standards". He mentions that Portugal needs not to worry in excess with theoretical risks.

The EU is skeptical about China not being a western democracy, about its track record with HR, and because it still has standards of living and society which are not yet fully compatible with the western standards. He does not have the illusion that, in 2050, China will be a western democracy, but the West is more likely to influence China, the other way around.

Dr. Luís Sáragga Leal is one of the founding partners of PLMJ, which is one of the law offices with more activity with Chinese Investors and has been involved in most of the Chinese transactions in Portugal.

Overall, he is very supportive of COFDI, which has some pitfalls but also many advantages versus other FDI: **"**I think there are some positive aspects about COFDI".

He would prefer that Portugal has a deeper scrutiny in terms of controlling FDI in sensitive assets, but he believes the current stock of COFDI does not endanger the Portuguese political autonomy: "at this moment, the Chinese participation in Portugal is not worrying. Do they want to influence the national politics? I do not think so".

He believes that Portugal should use its access to the Chinese to enable the development of 3-4 key projects, namely the new airport, the TGV to Spain, and the upgrade of the Port of Sines.

From his perspective, China saw in Portugal a source of tech, regulatory know-how and market access (to Africa, the USA and the EU).

He thinks that the COFDI decision process is more inductive than deductive (not like the west). There is a range of *apporteur affairs* which try to take investment opportunities up the structure, with a very low "conversion rate".

He considers that China will not try to acquire political control in Portugal because it would fail and even backfire, particularly through media vehicles:

> "Buying a media group to influence the Portuguese government, I think it would be a bad decision for the Chinese and I think that if they are well informed, they will never do it…the political influence through media and government bonds it not notorious".

Professor Manuel Caldeira Cabral was Minister of Economy between 2015 and 2018. Moreover, he has also been a journalist at Diário Económico and Semanário Económico. Currently, he is member of the Board of ASF (Insurance and Funds Regulator) and Professor of Economics at Universidade do Minho.

He believes that COFDI is important and that "the investment cases they have here are interesting and the Chinese have potentially others that can be interesting for us as well".

Portugal is important to China in the sense that it allows the access to assets which were, otherwise, unavailable to China. Besides that, "China found in Portugal a more interesting entry door (to the EU) than what China finds in Spain, Germany, France or even in the UK*"*.

According to him, "Chinese companies have a strategic long-term vision, which has to do with the strategic vision of the country. The investments have to do with establishing a network and a Chinese power, also in the medium/long term".

He considers that there is no real usage of economic power to acquire political influence, however, "in relation to the political pressure for economic purposes, I absolutely think that the Chinese Ambassador does that*"*.

From his point of view, too much was privatized, namely REN and ANA; these situations created monopolies which have no incentive to be efficient and increased the context costs: "The regulation that resulted from REN's privatization, is indeed unfavorable to the country and to the technological evolution*"*. For China it was very valuable because it allowed China to "take advantage of the know-how that we had in relation to the renewables, as something that could have interest in order to develop those technologies in China*"*.

Finally, Portugal must force China to uphold the utmost respect for regulation and local rules, which is actually beneficial for China since it allows it to gain know how in accessing the EU market.

President Marcelo Rebelo de Sousa is more than the President of Portugal: he is the most influential opinion maker in the country and probably the most popular individual. His position as President is so undisputed that he does not have presidential competitors from any of the center parties. Previously, he was Secretary General of PSD, a distinguished law Professor and lawyer, an influential journalist and a political commentator.

Regarding COFDI, he says that, at the time, there was no choice but to let the Chinese investors invest in Portugal, since the country was practically bankrupt, under Troika intervention, and the American and European investors were not interested in investing in Portugal. He mentions that it is possible that the emergency forced Portugal to sell a bit too much, and not as expensive as it could under other circumstances.

According to him, Portugal was an entry door to the EU, namely in some sectors which are not always available to the Chinese in other EU countries.

The President sees a very clear distinction between being an ally of the USA and an economic partner of China. The problem with being both is that Portugal's allies put it in a difficult economic position because they ask Portugal to behave in ways which are not necessarily in its economic interest. Also, he perfectly understands the American concerns about the rise of China: "I perfectly understand, and I empathize with the American position. If I were in their shoes, I would probably feel the same way".

From his perspective, the Chinese are not interested in changing the ways of living of the other civilizations, just like there is no chance for the West to interfere in the way that the Chinese organize themselves, and their core values. He considers that the Chinese do not even try to have political influence in the EU, whereas the Americans are still very influential and active.

Overall, he appreciates the existing stock of COFDI but believes that adding more COFDI cases should be well thought through.

Dra. Maria Luís Albuquerque has been Minister of finance, Secretary of State of the Treasury and financial director of REFER.

She supports all FDI: "our position, as government, was to support all foreign investment of quality*".* When comparing COFDI with FDI from other origins, she shares that "we did not discriminate against origins, provided that these were legitimate, and favored the value of the proposal in itself. We believed that Portugal really needs FDI, COFDI or any other FDI".

Speaking about the relevance of Portugal to China, she acknowledges that "Portugal became relevant to China for approaching the COFDI without prejudice, which is different from how the Chinese were received in several countries*".* She mentions that such treatment applied to both public and private assets "and they recognize that". Regarding the triangulation with the USA "the relationship between Portugal and the USA is not as relevant as we could wish... It was a very smooth interaction…I believe that the American companies do not invest more in Portugal because they do not find interesting opportunities here*".*

COFDI motivations are "clearly strategic*"* and "there is no motivation to influence our politics or our political regime*".* She downplays the possibility of China converting economic power into political influence: "first of all, we will not sell the entire economy to Chinese owners, and second, that is more a function of the ability of the governments to know their place than of the Chinese intentions". She admits that her government wanted to sell beyond what was requested from Troika: "we have always wanted more than that, we wanted to go beyond. And there we can see an ideological difference". Regarding specific cases, REN and EDP are

> "two separate companies but the ultimate beneficial owner is the same. We thought that the EU could have some concerns about it, but the fact is that the EU analyzed it and did not raise a concern. The concern would arise if there was the risk of collusion, but the fact is that EDP is not alone in the Portuguese market. It is purely a theoretical question at this moment".

Dr. Mário David is a very experienced Portuguese Politician, namely on what concerns European and International Politics. His career includes but is not limited to being a European Parliament Member, a Parliament Member (Portugal), Secretary of State of European Affairs (Portugal), Vice-President of EPP and Senior Advisor to several Governments (e.g., United Arab Emirates, Oman, Hungary).

He is supportive of COFDI: "I like all FDI in Portugal. So, I support COFDI as much as possible". The specificity of the COFDI is that "many times, not always, the investment is done by state owned or state-controlled entities*".* Regarding FDI, he recognizes that, by default, he would "prefer that it would come from other places, or private Chinese entities, because in the Chinese economy there is a lot of confusion on where is the line separating the party from the economy". The relationship between the EU and China is critical to both sides,

> "from the EU side it is important for its affirmation in the world and for commercial purposes. For China, you have a third factor which is to use the EU as a counter-weight in its battles with the USA and Japan – having a privileged relationship with the EU is one of the most important geopolitical and geostrategic objectives of China*".*

COFDI motivations are "based on economic opportunities". He considers that "there is no space for political motivations because of the low political relevance of Portugal". China will not pursue political influence in Portugal "because Portugal is not that relevant".

He is not against the Chinese presence in the Sines Port "although I would prefer Singapore... or any entity which I was sure that it was private*".* Speaking about the Lajes base, he does not have the same opinion: "it is such an important location for NATO that it will always be available for NATO…unfortunately they do not pay for permanent usages but whenever there is some noise it is activated. We are just not being paid for it as much as before". He criticizes REN on what can be regarded as clearly favoring EDP, when REN defended *"*for the National Energy Plan the prioritization an off-shore line for EDP". Because the two companies have the same ultimate beneficial owner (the Chinese state), that raises suspicion of concertation.

Dr. Miguel Frasquilho presided AICEP from 2014 to 2017, being responsible for attracting IFDI. He interacted with many Chinese investors and investors from other origins. At the time of the interview, he was the Chairman of TAP (previously invested by HNA).

Dr. Frasquilho values COFDI in Portugal: "through times, I have been very supportive, even because COFDI in Portugal is very recent", mostly because Portugal needs and benefits from investment, and Portugal is unfortunately not capable of investing on its own.

> "So, if we have COFDI in Portugal, I thought it was good for the economy. It was good in terms of diversification because it brings down the risk and I think it is also important to have a partner with the prominence of China, which is clearly achieving a very important status in the global economy."

Portugal is not irrelevant to China: "I think it is not indifferent to China and I think we are a country that the Chinese authorities and investors really appreciate". He sustains this position due to the Portuguese history, relationship with China, easy access to the CPLP and the position within the EU market. He advocates that China is a critical source of FDI and key to Portuguese exports. Consequently, as the country grows and gains relevance globally, it is beneficial for Portugal to keep strengthening the relationship.

He thinks that COFDI is still a small share of total IFDI and welcomes more of it: "they come, they accept the companies, they speak with other shareholders, and I think COFDI has been focused in buying companies, not in building projects from scratch". He believes that COFDI tends to keep the local management and does not see any attempt from China to try to convert its economic power into political influence: "I don't see any hidden intention or any harm intention towards us" and considers that it is possible to maintain Portugal's position in its system of allies while engaging economically with China: "as we are natural allies of the EU, the US and the CPLP, I don't see why we cannot be allies of China. It should be good for us". Lastly, he liked the presence of HNA in TAP and would like to have Asian investors again.

Mr. Miguel Relvas is an important politician from PSD. He has extensive experience from his tenure as member of Parliament (1985-2009), Secretary of State of Local Government and Minister of Parliamentary Affairs during the Troika period.

Overall, he considers that China positioned itself as the economic power and it looks to Portugal as a small riskless place, and as a means to strengthen that positioning: "China positioned itself in the world as the economic power... They came to study Europe where they thought it was less organized, easier to enter, smaller and with less risk". He believes that COFDI was positive to Portugal because it paid higher valuations, provided access to financing in a desperate moment and helped decrease the dependency from European sources. All this while respecting and maintaining local management.

Every Chinese investor is directly or indirectly linked to the Chinese state because there are capital controls, but Europeans tend to presume that the Chinese are more strategic, concerted and organized than they actually are. There is no intention to acquire political influence, instead China looks at the country as a laboratory to learn about Europe and Brazil: "Back then, Portugal was used as a lab ...I have always been convinced that they entered Portugal to understand the model and the management of the acculturation process observing Europe and Brazil".

China wants to acquire more economic power, not political power, and Portugal is politically irrelevant for them: "I think they are not interested in political influence. Portugal is too small…because the Chinese do not want to have political influence, they want economic influence".

We can now conclude that the sale of EDP to CTG was very good and selling it to the German bidder would have been worse. About Fosun, he sees it as an example of Chinese capitalism at its worse: FOSUN forced Fidelidade to invest in Fosun related assets and was both stopped by the regulator and the Chinese authorities.

Dr. Miguel Sousa Tavares is one of the most influential journalists and political commentators in Portugal. He is also a famous writer and holds a law degree.

When asked about the attractiveness of COFDI, he explains that "first, it is inevitable… then it depends. The problem about COFDI is that it is an investment which is connected to the state". He sees both opportunities and threats:

> "We can be a preferential market for China in Europe, I do not mean their largest partner, but we can be a pet partner, which would be very important for us. Therefore, on the one hand, I see advantages. On the other hand, I have concerns that derive from our smallness… it is a politically oriented market, if China becomes an important market for our exports, that makes us more vulnerable".

China looks at Portugal from a geopolitical perspective, not (only) driven by economic motivations. Above all, it values the potential of the ports and territorial waters: "let's imagine that they buy the Sines port… speaking about European and global terms, a relevant deep-water port is decisive for Europe and for the maritime traffic. That is a global strategic position*"*. Regarding political influence in the country, it is operated via the people hired by the Chinese to represent them: "the political influence over the governments is achieved through the people they nominate to their invested companies". At EDP, the Chinese kept the CEO

> "but then they nominate for the Boards people from the relevant political parties. They hired António Vitorino from PS, Celeste Cardona from CDS, Braga Macedo from PSD, and Eduardo Catroga. They cherry picked ambassadors from each party without knowing if the selected few had the capabilities to manage an electricity company".

He perceives the COFDI topic as very complicated and believes that it must be dealt with sagely. On the one hand, it allows Portugal to gain leverage over the EU, and allows "the EU to be the 3rd side in a bipolar world between China and the USA". At the same time, he would not allow the Chinese in Lages, and he would not sell them the Sines Port… but could do a concession, with a bullet proof contract, if that was feasible - he fears the inability of doing so: "unfortunately, in Portugal, the contracts which are negotiated by the state are disturbing".

Professor Miguel Teixeira Coelho has long been a key decision maker at Associação Mutualista, which is an important social sector holding with activity in multiple sectors, including banking (Caixa Económica Montepio) and insurance (Lusitânia), where he was Board member at the time of the (failed) acquisition attempt by HEFC. He is a distinctive economist and Professor, with a helicopter view over the Portuguese economy.

He thinks that attracting FDI for tradable sectors is critical to the Portuguese economy, whereas FDI in non-tradable sectors or monopolistic companies is not value-adding. These types of companies are prevalent in the current stock of COFDI in Portugal.

He conceives possible a version of the COFDI narrative which includes a master plan from China to gain some room in Portugal, as a step to other geographies and to learn, but thinks Portugal can play that in its favor.

From his perspective, Portugal is important to China due to the history of the relationship, which creates a perception of respect:

> "I think Portugal has a central role between China and the EU. The Chinese seem to appreciate that importance. There are historical aspects, but they look at the role of Portugal geographically. The historical component that we developed through Macau and other contacts from the past centuries, gave high reliability to Portugal, which make the Chinese feel comfortable in their relationship with the Portuguese".

He believes that China is central for Portugal because of its ability to inject capital, but also because Portugal can position itself between China and the EU, given their different specialization (massification vs. scientific development).

In the case of the CEFC investment attempt in Lusitania, the objective was to start from insurance, develop it in EU, and in Macau, but followed by an investment in the bank. The case felt due to compliance issues in Czech Republic and the management of CEFC being fired.

Dr. Nelson Machado is a businessman with extensive experience in Banking (e.g., BCP) and insurance (e.g., Ageas). He is currently CEO of Ocidental Seguros, which is 49% owned by Millenium BCP, whose largest shareholder is Fosun. So, he has an indirect link with COFDI.

He is very supportive of COFDI, which was extremely important when it arrived:

> "China is important to Portugal. It was very important. It was probably decisive six years ago and I think it is still important. So, I would say that the more COFDI, the merrier. I wish it was not this much of the total investment".

He believes that, at the time, Portugal probably privatized too much but there was no alternative: "I think we sold more than what we should have… but I do not know if there was an alternative". He is only concerned with the fact that there starts to be too much concentration in one origin.

From his perspective, Portugal became relevant to China through COFDI. The Chinese found in Portugal a country which welcomed them and allowed them in sectors which were closed to them elsewhere. He considers that China was alone in solving the critical problem of lack of capital in a moment when only very aggressive and short-term focused investors were bidding for Portuguese assets.

Not wanting to be naïve, he understands the conceptual possibility that China could try to use its economic power for political objectives, but he believes that there are no signs of such motivations to date: "I do not want to be naïve, so, maybe there are political motivations, but, honestly, I do not think that they are the main driver". From his point of view, COFDI seems to have been mostly driven by economic drivers such as the search for know-how and access to new markets, at good valuations.

He does not disagree with the Chinese presence in insurance, banking or EDP, but he does not understand why REN was privatized and sold to the Chinese investor (CSGC).

Dr. Nicolau Santos is a prominent journalist in Portugal. He is the Chairman of the Board of RTP. Before, he has been Chairman of the Board of Lusa News and deputy director of Expresso. From his perspective, FDI in Portugal can be divided in 3 types: Spanish FDI, COFDI and all other FDI. He has a neutral position in relation to the COFDI:

> "COFDI was fundamental to Portugal when it arrived, its features are not ideal for the Portuguese economy because they do not invest in new production capacity, greenfields etc. Also, it does not add anything in terms of management, technology, or access to new markets... The world is not *black or white*, and neither is COFDI".

He considers that the Portuguese do not account properly for the relevance of cultural and historical dimensions of the relationships among countries. His experience taught him that there is, from the Chinese side, meaningful historical respect for Portugal and some notion that the Portuguese stance regarding the Macau transition was always very respectful. Therefore, he believes that "Portugal is more relevant to China than what our fair share according to market size would indicate*"*.

He adds that "Portugal and the USA are slightly drifting apart, despite not very explicit in the public communication. It seems that Portugal will keep its non-critical stance towards China*"*. In part, this is justified by a notion that COFDI has no political motivations *a priori*. He believes that China saw an opportunity to establish itself in the EU and grabbed it, but Portugal was not an entry door to the EU, since they already had several investments in other European countries. When China wants to pull its weight, it does so "mostly through diplomatic means… when there were some issues regarding the EDP rates, it was the Ambassador requesting an audience and exposing the Chinese frustration*"*.

Regarding the performance, some COFDI cases were successful namely EDP and REN acquisitions. However, "they are not always successful: the investment in BESI does not seem to have been successful. In Global Media is still of unclear success*"*.

Dr. Nuno Rogeiro is a distinguish international political commentator. He has been teaching at the Law School of Lusíada University, journalist at multiple newspapers, magazines, radios, TVs, and author of multiple books. His access to classified information is legendary.

According to him, the main constrain to COFDI relates to the juridical and political nature of the investment companies, because as per constitution, every company in linked to the government: "Whereas the investments of other countries are essentially from mixed or private companies, here we have to say that COFDI are all public or quasi-public investments*"*. China has tried to use private-like companies from Macau or HK, but these still do not have the dimension to compete in top global stages. He believes that COFDI was mostly driven by the Portuguese weakness. Out of necessity, Portugal was willing to sell assets which other countries were not. At the time, not even the USA opposed the sales of EDP and REN. Now there is pressure against buying 5G from Huawei and to stop selling companies to the Chinese.

Portugal "is important to China, but maybe not for the reasons that are usually pointed out" there are many doors for China to enter in the EU, however, Portugal is a door for the CPLP including Brazil. China has not been investing in job creation: almost 100% of COFDI has happened "to prevent the closure of a company".

China acquires political influence to have negative veto power (i.e., to avoid general criticism of its development model), but there is no chance of having positive veto power to the point of coercing the EU in changing its own model. KNJ's stake in Global Media is the most sensitive in Portugal) because the main Chinese concern in the EU is precisely to carefully monitor any propaganda against its economic and political models:

> "The issue about the media is the following: in television I might have to decide if I start the news with a riot in Tibet or with riots in HK. Would a Chinese company, which is connected to the Chinese state, accept that the opening of the news was about that problem? That is the big question*"*.

Dr. Paulo Portas is the most influential politician and opinion maker of Portugal's right-wing space. His experience includes being Minister of Defense, Vice PM, Secretary General of CDS-PP, political commentator, journalist and academic lecturer in six universities worldwide, including in Beijing.

He does not discriminate any origin of FDI, despite the different geopolitical implications of the different alternatives. He adds that "given our exiguity, I am against too much dependence on individual relationships. If I have several friendships, I am not dependent".

He says that "not only the Portuguese and Chinese know each other for centuries, but they feel like family". Portugal is relevant as an entry door to the EU and "obviously the Chinese take an interest in the EU in their challenge to the American leadership*"*.

About motivations, he thinks that "when they invest in technological areas, they obviously have the aim to leapfrog and rise one more level from the technological perspective".

He is not concerned about the potential political influence of China in Portugal: "the expansive period of China in relation to the EU is already behind us*"*. From his point of view, the Chinese embassy has much less influence in Portugal than the American embassy and the EU.

About the privatization of REN, if Portugal wanted to discriminate against China, it would have sold to the German bidder for less than 1/3 of the Chinese valuation, which would not make any sense:

> "The prejudice does not have economic rationality in assessing a competitive bid, and if we discriminated the Chinese, we would never be able to convince the rest of the world that non-Europeans could win a privatization tender in Portugal. They would stumble upon the evidence. If the proposal was better, how could I explain saying no to them?".

He considers that there are some sectors which should not be privatized, and that includes CGD (state owned bank) and the water sector (which already has some foreign ownership, including Chinese investors).

This anonymous interviewee is a former senior executive of Parpública, a holding of the Portuguese state. This entity was involved in the privatizations, although it does not decide what is alienated or to whom. It is the executioner, therefore, responsible for the good execution of the process. The view from his angle allows a perspective on the ability of the state to manage, alienate and regulate economic participations.

COFDI "has a beneficial impact, but things should be dosed so that in the end we are not "presented with a bill. There seems to be some room for maneuvering". COFDI should be used as a complement to other FDI, with due precautions and in proportionate size,

> "I assess what should be given to the Chinese in a geoeconomic chessboard, including several precautions which are necessary, namely avoiding too much power in the hands of external entities who may be driven by interests different from ours".

He considers that any FDI needs to be controlled and monitored, and there should not be a sectorial concentration in the same origins. There is a major difficulty in the regulation of the economic activity due to the low quality and independence of the regulation officials, which is explained by the current rules for appointment and salaries paid.

He sees China as an alternative source of investment. There is no point in ignoring the obvious differences between the political regimes, but all origins are bad when one gets too much. He was never pressured for the support of any origin and appreciates that very much.

He does not understand why EDP, and REN participations were alienated to the same beneficial owner: "Speaking about REN or EDP, I truly do not understand the reason why they are both in hands of the same ultimate beneficial owner". He feels that the privatization of water companies probably does not pay off when we balance the pros and the cons, because the water distribution "has a relevant impact which can be dramatic. It has a value which is not that monstrous. It is profitable, but not that much profitable. and I think that, balancing the pros and cons, it is not worth it".

Dr. Pedro Filipe Soares is the parliament leader of Bloco de Esquerda, and its reference for foreign affairs. Before, he was an academic researcher in electronics, systems consultant, developer, and integrator. Dr. Filipe Soares represents the institutional perceptions of *Bloco de Esquerda*, the largest left-wing party in Portugal.

Speaking about COFDI, he mentions that Portugal "does not differentiate FDI in abstract. On the specifics, on the several purchases of strategic companies, yes. Not because it is Chinese, but because it is an investment in strategic firms under the umbrella of the Portuguese state".

Bloco de Esquerda does not ignore that the Chinese state is behind the COFDI: "The economic interests and the investments in China are not separable from their political interests". But the same happens with many investments from large western corporations from the USA and the EU. COFDI followed good business deals but more than that: "we are a dual entry for China. A door to several strategic interests in Africa… and an entry in Europe". COFDI also looked for gaining know-how in strategic companies. EDP, for example, pays good dividends while also giving access to the USA, and Latin American markets.

When asked about political motivations, he believes that there may be some political intentions, but they "are not declared. But it is hard to understand (even now) their total reach". And about political influence: "The direct answer is 'yes, they have'. The problem is saying how much… any of these big players is capable of pressuring the Portuguese state".

He mentions that too much of the Portuguese economy was privatized during the Troika period and has a much more statist view about how the economy should work. In this sense, he adds "The EDP example, REN... are strategic companies which should not have been privatized. ANA, likewise". For him, the privatization of these companies prevents the country from having national champions able to compete in the international arena.

Dr. Pedro Passos Coelho was PM of Portugal between 2011 and 2015, Secretary General of PSD between 2010 and 2018, financial director and manager in private companies and guest lecturer at the Lisbon Institute of Social and Political Sciences. He is forever associated with his successful role in steering Portugal out of the financial sovereign crisis which required the intervention of Troika, and with the austerity measures that his government was forced to implement. For him, COFDI in Portugal needs to be understood in the context of the external intervention under Troika, arriving

> "at the time when a significant window of opportunity was open, and they entered well because they saw value in the assets that where being privatized. Besides that, they strengthened financially some companies which needed access to capital and financial muscle that the Portuguese state could not guarantee".

He explains that his government was confronted with a financial envelope from Troika which was shorter than needed, due to poor accounting of public companies which required support from the state. That justified the necessity to privatize beyond the EUR amount initially forecasted (~9Bn vs. 4.5Bn): "One of the ways we had to solve that restriction was to privatize beyond the initial plan".

He recognizes that "China may intersect more with the Portuguese interest in Portuguese speaking Africa, since there are very significant Chinese investments there". Regarding the importance of China to Portugal, he clarifies that China is not a main pillar of the country's strategy, even if it is a very important and rising power which cannot be ignored and a country which generates very large amounts of savings which generate liquidity to invest abroad.

Regarding the potential political influence, he is clear in assuring that he never felt any constrain to his political freedom due to COFDI or any other FDI: "Neither COFDI nor any other. FDI has never been a constrain to the political decisions in Portugal… in a political or diplomatic manner". He reminds us that many "European industrial companies were owned by their states for a long time".

Dr. Ricardo Salgado is consensually perceived as one of the most influential businessmen in Portugal since the 1980s. He was the leader of Grupo Espírito Santo, the cornerstone economic and financial group in Portugal. He interacted with most businessmen, politicians, and investors in the country.

From his perspective, despite recent growth, COFDI is still a small share of global FDI when compared to China's share in global GDP. He welcomes COFDI after seeing how it behaves in Portugal: "China has revealed wisdom in its approach to the EU market. The historical relationship with Portugal also proves willingness to play by the rules and never aggressive". This contrasts positively with "vulture" funds, which focus on maximizing short-term profits. He considers that Portugal needs to play well its privileged relationship with China and the CPLP. COFDI can be instrumental in solving structural problems and catapult the Portuguese companies globally:

> "I see COFDI as very positive if it is integrated in long term partnerships in which the Portuguese invested companies become platforms for foreign expansion, namely to Europe, Latin America, Africa and even Asia. Portugal has a vulnerability of lack of equity capital and over indebtedness, thus COFDI can be a remedy. At the same time, China needs to respect WTO rules and accept the principle of reciprocity".

It is important to enforce regulatory limitations to FDI in sensitive assets and political party financing. Nevertheless, there is no evidence that China has tried to obtain political influence in Portugal, nor is it likely to pursue it in the future: "I do not see what interest China would have in pursuing political leverage in Portugal. The rules derive from the UE framework which needs to be respected rigorously".

All in all, COFDI is helpful, not harmful, and it generates goodwill which is beneficial to both parties. On a broader note, Dr. Ricardo Salgado considers that the EU faces the challenge to be a global power alongside the USA and China but remains struggling with its own unity.

Dr. Sérgio Martins Alves was the president of the Portugal-China Chamber of Commerce at the moment of the interview. Previously, he was diplomatic and media advisor in the socialist party and its governments, namely diplomatic advisor to PM José Sócrates (2006-2011), and coordinator of the international relations office of the socialist party (2004-2012).

He is a supporter of COFDI, but critical of the sectors to where it was channeled. He would prefer that COFDI was directed to greenfield development of critical infrastructures still missing (Lisbon airport, Sines port, high-speed highway, etc.) or production facilities of tradable goods. He criticizes that the PSD government "gave up the airport, gave up the high-speed train and sold the few rings that he (PM Passos Coelho) had, regardless of who was buy them, as long as he received money?".

Portugal is not relevant to China: "We are not relevant at all*",* what happens is that Portugal is so open and friendly to COFDI that it becomes a perfect target, where their go-out strategy fits perfectly – Portugal allows them to acquire relevant assets at good prices, which can then be used to access the EU, Africa and Brazil.

Curiously, China allows Portugal much more senior bilateral access than other powerhouses:

> "Despite being NATO members, we do not have the same political proximity with the USA. In the last 40 years, we met the American president on the highest political level infinite times less than the Chinese, and one can add the Brazilian president".

The political nature of SOE capital is an advantage because it offers a channel of influence from Portugal to the Chinese leadership which works as a buffer of economic impact.

The Chinese political influence in Portugal has increased exponentially and China is willing to try to use it to avoid criticism in several areas, such as for media and diplomatic issues, however this does not mean that Portugal is any close to adhere to such demands.

He considers that it is legitimate for China to aspire to grow economically and to adjust the international rules and the international order to incorporate its input…but a line must be drawn on using political influence and constraining the freedom of expression.

Dr. Sérgio Monteiro was Secretary of State for Infrastructure, Transport and Communications from 2011 to 2015. He oversaw the privatization program under Troika. He is Managing Partner of Horizon Equity Partners and has been Board member of Caixa BI. He was also advisor to the *Banco de Portugal* in the sale process of Novo Banco.

He mentions that when Portugal desperately needed investment, the Chinese were among the few willing to invest: "the Chinese saw an opportunity, they believed in our recovery and in the companies' value*"*. Moreover, "after the purchase, a lot of financing came, not just capital for the state, but also financing for the economy". Therefore "I would say that the balance is positive for Portugal*"*.

From his perspective, Portugal "is slightly relevant for China…not a priority country". He considers that the economic relevance is slightly higher due to the potential support in accessing new markets, namely the EU and the CPLP, which are very relevant to China. Moreover "they could also do the upgrade of their own technical knowledge, which made them value a little bit more those investments".

He does not see political influence nor the existence of powerful interest groups: "I do not feel it. I do not feel that exists a lobby. There are no spearheads of COFDI in Portugal, at least they are not very visible. From my perspective, they are not very visible".

The privatization had two targets: the specific list of companies and a total EUR amount. Once Portugal reached the total EUR amount there was still the pressure and commitment to sell the remaining companies, but there was also the need to do so because the macroeconomic figures were worse than expected, and the deficit was larger than expected.

He notes that Fosun has had major blows in its investments in Europe (e.g., Thomas Cook). Regarding that, he is surprised that "the regulator had accepted that Fidelidade subscribed so much debt from his shareholder Fosun, which had just bought it. There was also a liquidity drainage in Fidelidade with the regulator's acquiescence".