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From the Editor: In this issue of showCASE, our analysts take a closer look at the new FDI (Foreign Direct Investment) screening tool, which has been recently endorsed by the European Parliament, and at how is it connected with Chinese involvement in the European Union.

European Parliament's Valentine's Day Gift to the EU: the New FDI Screening Tool

By: Katarzyna Sidło, CASE Political Economist and Anna Csere, CASE Intern

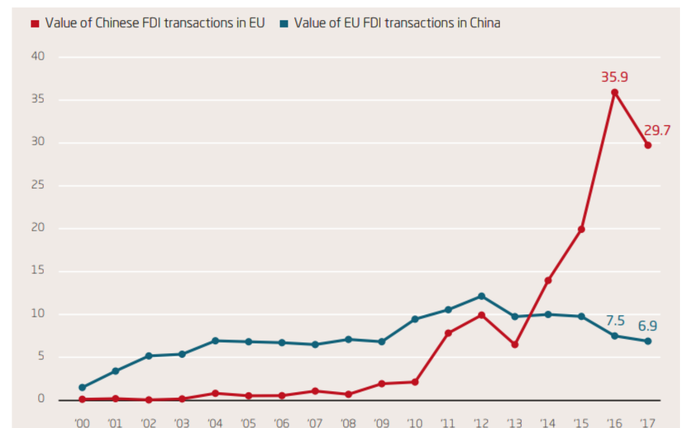
On this year's Valentine's Day (February 14, 2019), the European Parliament reached an agreement to create a foreign direct investment (FDI) screening tool. Designed to protect sectors and technologies deemed critical to European Union's security from investments made by enterprises that are state-owned (SOEs) and/or have a non-transparent ownership structure, the new regulation was presented by the European Commission as crucial in light of "rapidly changing economic reality [and] growing concerns of citizens and Member States".

The importance of the move for the EU can perhaps be best attested by the sheer speed with which the proposal has been pushed through the legislative process. Indeed, proposed by the EC only in September 2017 on grounds of security and public order, the provisional text of the framework was published – uncommonly for the European Union – without a dedicated impact assessment (although public consultations with both Member States and stakeholders have been conducted). Since the FDI screening falls under the common commercial policy, its establishment or non-establishment is EU's exclusive competence. As such, it is expected that it shall be adopted by the European Council in March 2019 and become effective within 18 months after being published in the Official Journal.

Better coordinated investment rules in the EU have been long overdue. The EU Member States' economies are increasingly intertwined in the European Single Market, and Europe is experiencing far-reaching repercussions of a globalizing world. Indeed, patterns of investment relations have been undergoing profound changes, with the EU countries no longer net outward investors but rather net investment recipients (number one in the world in terms of cross-border mergers and acquisitions). At the same time, Asian countries – in particular China – became one of the major sources of outward investments. In 2016, Chinese FDI flows to the EU jumped to approx. EUR 35.9 billion, up from EUR 20 billion the previous year, more than four times higher than the value of EU FDI flows to China (EUR 7.5 billion). Western Europe is a favourite destination for Chinese FDI flows: the Netherlands, the United Kingdom, France, Germany, and Sweden accounted for 90% of China's total direct investment. These are, however, mostly acquisitions whereby Chinese investors, having access to cheap capital back in China, acquire technologically advanced European firms together with their intellectual property. While acquisition of technology is part and parcel of international commerce, when such transactions are subsidised or otherwise influenced by governments, their normally beneficial effects cannot be presumed. Although portfolio investment is not covered by the new proposed regulation, it is worth mentioning that Chinese non-FDI investment is also on the rise, including venture capital and portfolio investment stakes of less than 10%. Daimler and Deutsche Bank in Germany are one example of the acceleration of non-FDI inflows from China to the EU.

The influx of Chinese capital has met mixed reception in Europe. While it has undoubtedly come as a financial boost to many national economies, concerns are being raised about potential security and competitive risks associated with the growing economic clout of Beijing. China has not yet delivered on its promises to liberalise its economy and implement market-oriented reforms. The Chinese government heavily intervenes in the domestic economy and in the inflows of FDI going to China to advance the competitive and technological position of its enterprises to the detriment of foreign entities.[1] Reports are also emerging about Chinese attempts to extract know-how and key technologies through takeovers and acquisitions of strategic assets abroad. This form of technology transfer receives state support, thereby leading to distortion of competition in the industrialised countries concerned. Chinese Midea's acquisition of the German robotics company Kuka has been one of the biggest and most debated transactions so far. Critics of selling sensitive technology warn of the political motivations of the Chinese leadership. Indeed, the new Chinese industrial policy plan ("Made in China 2025") clearly demonstrates how Chinese takeovers are driven by motives other than purely commercial interests.

Figure 1 China/EU FDI movements



Source: Rhodium Group via MERICS

Unsurprisingly, then, many countries have been increasingly more vigilant and starting to tighten their national investment screening schemes, targeting notably investments by SOEs.[2] France, Germany, and the UK have all extended their rules so that a wider group of foreign investments can be subject to closer scrutiny and a veto by the government. However, they are among only half of the EU Member States that do have FDI screening tools. This, combined with the fact that those that are in place all over the Union vary in scope, which makes the EU as a whole vulnerable to investment made by opaque companies – especially Chinese ones – has been pointed out in various EU communications and analyses.

Against this background, in the new FDI screening framework the EU pushed for tougher measures than originally envisaged, although – as a way of compromise between the original EC proposal and EP's updated proposition – Art. 8 of the Provisional Agreement clearly states that "[t]he decision whether to set up a screening mechanism, or to screen a particular foreign direct investment remains the sole responsibility of the Member State concerned". At the same time, minimum requirements for any FDI screening tool in place have been listed. Moreover, in an effort to boost intra-EU cooperation on the topic, a formal cooperation mechanism and a cooperation group between MS and the EC has been proposed as well. Collaboration is also to be promoted through transparency and information requirements. For instance, MS will be required to report to the EC on FDI on their territories on annual basis. Finally, the EC will be given a new prerogative to perform the FDI screening itself and issue non-binding opinions for MS in case FDI in a given MS may have an impact on the security or public order in any or all of the EU Member States. The rules will be applicable to investment in critical infrastructure and technologies (e.g. aerospace, energy, media, health or water), supply of critical inputs, access to sensitive information, and media freedom and pluralism.

[1] See for example, Kowalski, P., D. Rabaioli and S. Vallejo (2017), "International Technology Transfer Measures in an Interconnected World: Lessons and Policy Implications", OECD Trade Policy Papers, No. 206, OECD Publishing, Paris. http://dx.doi.org/10.1787/ada51ec0-en

[2] See for example Kowalski, P. and K. Perepechay (2015), "International Trade and Investment by State Enterprises", OECD Trade Policy Papers No. 184, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/5jrtcr9x6c48-en

Figure 2 Formal FDI screening mechanisms in the EU (as of February 2019)

Source: European Parliamentary Research Service

The new FDI screening framework has been approved by a whopping 500 votes (with 49 against and 56 abstentions). This is despite reservations on part of some states, for instance Greece, which saw significant Chinese FDI inflows generating massive infrastructure projects. For example, in 2016, the state-owned China Ocean Shipping Company bought a 67% stake in Greece's Piraeus Port, which became the main entry point into Europe for Chinese companies. A memorandum of understanding on cooperation in areas of energy, environment, information, communications technology, and transport has also been reached between the two countries. Greek Prime Minister Alexis Tsipras declared that Greece intended to "serve as China's gateway into Europe", thus showing no signs to put in place potentially deterrent screening measures. In contrast, Germany was one of the authors of a letter sent to the Commission, where concerns about "the lack of reciprocity and about a possible sell-out of European expertise, which we are currently unable to combat with effective instruments" were expressed – despite or perhaps because of the fact that in 2016 it was the largest recipient of Chinese inward investment into the EU (mostly taking the form of acquisitions of high-tech companies). In fact, new inflows of FDI led Germany to lower the threshold for screening and blocking purchases: since December 2019, the authorities can intervene if a non-European firm buys 10% stake of a company. At the same time, though, the Bundesrat expressed concerns that the new EU-wide FDI screening mechanism may be "perceived as protectionism" and adversely affect the EU's competitiveness.

Germany is by no means the only country to express such fears. Many other national authorities and stakeholders, as well as academics, have raised similar concerns. However, doubts are also raised regarding the feasibility and efficiency of the new tool, as variances in threat perception could lead to inconsistency in implementation of the EU-level measures or even to blocking viable investments. On the other hand, vague definitions may potentially result in the circumvention of the screening process in the pursuit of mere economic ends. Failures to act collectively could ultimately prevent the EU from building leverage and presenting negotiating power vis-à-vis other global economies. A lack of intelligence capabilities and human resources has been pointed out as another obstacle to running a well-oiled EU-wide screening system.

The EU is not facing an easy choice. Sticking to its principles of openness and free investment is not only a point of principle. In the era of growing populism, Brexit, and nationalisms, the EU must stand up for its fundamental values to maintain its appeal, integrity and, ultimately, unity. At the same time, vetting certain FDI investments is more than justified when thinking about the economic, strategic, and security interests of the Union. The biggest challenge will therefore not be to give the new laws a final approval, but to resist the temptation to overuse them, both on part of the national governments and the European Commission. The line between protectionism and protection is very fine indeed.

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Trade, Innovation, Productivity

Good Results of the Polish Economy

The Polish economy seems to be doing well amid poor readouts in the EU and around the world. According to this week's release by Statistics Poland, the country's central statistical office, the industry's sold production in January grew by a healthy 6.1% y/y and 7.4% m/m (6.1% and 1.7%, respectively, after seasonal adjustment). Despite the Purchasing Managers' Index lingering below 50 since November, suggesting pessimistic moods in the industry, consumer confidence at home and orders from abroad keep Polish manufacturers busy. Indeed, among the sectors that recorded the highest growth many were export oriented, including electric devices (17.3% y/y), other transport equipment (13.3%), and computers, electronics, and optical equipment (10.9%). This keeps the demand for employees continually high and offers prospects for a strong start to 2019 after 2018 finished off with a commendable 5.1% of economic growth (early estimate, unadjusted seasonally).

Free Trade Still Fares Well

The beginning of the year brought some good news for the proponents of free trade. On Monday, January 21st, Ukrainian and Israeli authorities announced having signed a free trade agreement. The long-awaited deal is to liberalise industrial and agricultural products' markets. The authorities believe that during the next 5 years, the volume of trade between the two countries will increase by 15%. Free trade was also discussed at the end of January (19-20) during the Arab Economic and Social Development Summit by leaders of 20 Arab countries, who called for establishment of a pan-Arab free trade zone. Attempts at promotion of free trade have a long – if not very successful – history in the region from 1945 when the Arab League was created, with the Greater Arab Free Trade Area (GAFTA) being brought to life with the signature of Agadir Agreement in 1997. A deeper and wider trade agreement would be welcome, although judging by the sheer absence of all but two heads of states during the summit (most countries sent prime ministers or foreign ministers) chances that the new zone will come to life any time soon are slim.

Labour Markets and Environment

Wage Gap Still Persists

According to the ILO's Global Wage Report 2018/19, on average women currently continue to be paid approximately 20% less than men. Much of the gender pay gap cannot be explained by any of the objective labour market characteristics that usually underlie the determination of wages. In high-income countries, for example, almost all of the gender pay gap remains unexplained. Yet, what stands out as key gender pay gap factors are occupational segregation and the polarisation by gender of industries and economic sectors. Gender polarisation and motherhood are also important factors. The latter brings about a wage penalty that can persist across a woman's working life while the status of fatherhood is persistently associated with a wage premium.

Money Does Not Buy Happiness

It appears that money does not buy happiness (at least not the money you can earn yourself) – in line with the Easterlin Paradox, the available evidence suggests that growing national incomes contribute weakly to human happiness (well-being), calling into question the existing economic productivity and growth models. For example, as reported in the World Happiness Report 2018, Poland opened the list of the Central and Eastern European economies, ranking #42 in the world. The rest of the advanced emerging (or only emerging) economies lagged (far) behind: e.g. Lithuania (#50), Romania (#52), Latvia (#53), Hungary (#69), and Belarus (#73) (with only the Czech Republic eluding this trend – #21).

In all these cases money (GDP per capita or productivity) did not buy well-being. Neither did the freedom to make life choices nor generosity or trust for that matter. It was “social support” that fuelled human happiness, not only in the region but globally as well. Still, it was the Central and Eastern Europe where its dominance over other factors was the most pronounced, at least in the continental context.

Macroeconomics and Public Finance

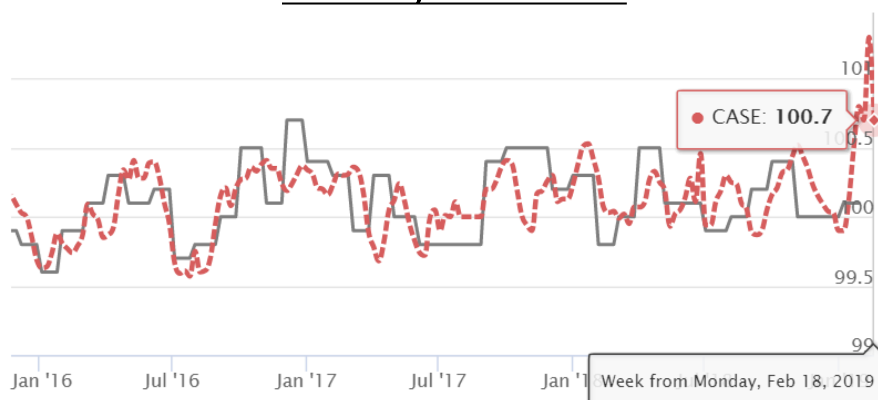
“Your e-PIT“ service is offered by the National Tax Administration (KAS). It allows KAS to automatically prepare and make available an annual tax return on the basis of the data in its possession. The use of this service is a concrete benefit for the taxpayer: time savings, no risk of late settlement and for the state cost savings. In this interesting and innovative initiative of the KAS one can find the implementation of elements of the behavioural approach, which is successfully used in many countries for public management and public policy. The philosophy of the behavioural approach boils down to persuading and directing the citizen towards desired behaviours and choices, which the regulator considers optimal while leaving him/her free to choose. In some countries, the behavioural insight units are responsible for the implementation of the behavioural approach. In Poland, it seems that there is no such unit yet, and the ideas for implementing this approach are still dispersed. Maybe it would be worthwhile to discuss whether instead of achieving specific results through e.g. regulations it is not worth to use a behavioural approach in a coordinated way and to consider setting up a unit which would coordinate these issues for the whole public administration.

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi.

Mid-February Online CASE CPI results show a very dynamic increase in average prices. The most important factor in that change was a significant hike in prices of electric energy – compared to mid-January prices went up by more than 8%. Another category that affected the price index considerably was *Food and Beverages*, where average prices increased by almost 1%. Among the most significant changes were prices of vegetables (a 4% increase), bread (2.2%), and flour (1.6%).

Our Weekly Online CASE CPI



Online CASE CPI (----) vs GUS CPI (——)

Monthly CASE Forecasts for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices	Nominal monthly wages
2019	3.5	3.6	3.3	3.8	3.0	7.5
2020	3.0	3.2	2.5	2.5	3.0	4.0

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