SAFEGUARDING OUR SYSTEMS:
MANAGING CHINESE INVESTMENT INTO THE UK’S DIGITAL AND CRITICAL NATIONAL INFRASTRUCTURE

BY DR JOHN HEMMINGS
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July 2017
'It’s a good report and timely. There is a lot of naïveté in regard to China by western governments and businesses alike. China knows its political model is unattractive in the West but it has found that its money exercises a powerful attraction. It shouldn’t be forgotten that China is still heavily dependent on Western technologies but there is a clear set of strategies to redress that imbalance. That is not to say that western states cannot do business with China nor accept Chinese FDI. But they need to do so with their eyes open and with clear strategies of their own.'

Nigel Inkster
Former Director of Operations and Intelligence, SIS

“The UK is entering a period in which we must warmly welcome OFDI into our economy. It’ll be good for jobs, good for rebuilding infrastructure, and good for our communities. However, this does not mean that we should welcome unfettered access to every corner of our high-tech economy and our critical national infrastructure.

“Britain needs an independent investment review body, which brings together our trade experts and our security experts, to screen foreign companies and state-owned enterprises attempting to buy access to sensitive parts of our economy. Big data, dual-use technologies, and the protection of our national infrastructure should be at the forefront of this new body.

“The Americans have CFIUS, the Australians have FIRB, many of our friends and allies have review processes or units who help screen foreign investment into their infrastructure in an open and transparent manner. It is high time that the UK developed one too: for the protection of our infrastructure and technologies, and to give foreign investors more security and confidence in the process.”

Lord James Arbuthnot
Former member of the Intelligence and Security Committee
Former member of the Defence Committee
SAFEGUARDING OUR SYSTEMS

About the Author

Dr John Hemmings is the founding Director of the Asia Studies Centre at the Henry Jackson Society and an adjunct fellow at the Center for Strategic and International Studies. He has also just completed a PhD in international relations at the London School of Economics, where he focused on security issues in the Asia Pacific region. Prior to his current position, Dr Hemmings was a research analyst in the Asia Programme of the Royal United Services Institute, where he focused on foreign and security policies in the Asia Pacific.

Additionally, Dr Hemmings was the UK Secretariat in the UK-Japan 21st Century Group in 2013 and 2015, and in 2015, was invited to join the CSCAP-EU committee in Brussels. He has given briefings to the Foreign and Commonwealth Office, to US Forces Korea, and to the UN Commission of Inquiry on Human Rights in the DPRK. He is the author of a number of book chapters, academic journals, and newspaper articles commenting on Asia, contributing to the BBC, the Telegraph, Fox news, Channel 4, CNN, the Diplomat, Al Jazeera, among others.

Acknowledgements

I am grateful for advice, comments, and discussions with Katie Parrett, Ross Cypher-Burley, Sophie Bolsover, Andrew Foxall, and Timothy Stafford. I am also grateful for the research assistance of Josephine Anzoulay, JanJan Sun, and Henry van Oosterom. Finally, I am grateful for those who contributed in some manner, but who must remain unnamed.
Executive Summary

- China's investment into Western advanced economies – including that of the UK – is increasing and changing in scope surging from EUR 14 billion in 2015 to EUR 20 billion in 2016, a 44% jump. More than 60% of the value of deals has been by state-owned enterprises, indicating this push is led by state strategy than commercial interests.

- In 2016, China invested $11.15 billion into the UK. More than double the amount in 2015 and the most in any one year going back to 2005.

- China's economic strategy, Made in China: 2025, might threaten the long-term survival of UK businesses unless some sort of government protection is afforded to them or unless China affords British businesses more access to China's home market.

- Because of cyber vulnerabilities, critical national infrastructure will be at the forefront of any future war.

- The current review system could be improved and rationalised:
  - It has allowed access to the UK's digital and critical infrastructure with elements of China's defence industrial concerns
  - It has allowed deals that have affected the UK's closest military allies
  - It allows for domestic and foreign pressure on the government of the day

- A formal investment screening regime is both necessary and desirable to protect the UK's economic interests and its national security.

- A new regime should be built, which is adequately resourced to carry out the difficult task of tracking foreign direct investment (FDI) into the sensitive parts of the UK's economy.

- The new regime should begin to coordinate more closely with the UK's closet military and intelligence-sharing allies, including the Five Eyes partners and NATO member states.

- Any new regime should carry out its review process in a judicious but swift manner so that foreign investment in the UK is not hampered or harmed. This report suggests that the regime should be sufficiently able to pass its decisions within 30 days of receiving an inquiry.

- Ideally, any regime should be overseen by a special committee in Parliament to ensure that it is sufficiently funded and resourced to carry out its activities, and that it is carrying them out in a legal, expedient and sufficient manner.
Introduction

Since 2005, China has invested more than $44 billion into the United Kingdom. Ranking fifth globally, the UK is the top European destination for Chinese direct investments. A number of factors have contributed to this prominence, including Britain's historically liberal business culture, mixed with strong political support. The UK is particularly reliant on foreign investment because it has a large current account deficit. Chancellor George Osborne's policies marked the high point in attempts to create a “golden age” in Sino-British trade, which aimed to make China the UK's second-largest trading partner by 2025. Under British Prime Minister Theresa May, this effusive approach has become more nuanced, balancing an open door to investment while also taking stock of security concerns. One of May's first decisions in office, for example, was to delay the approval of the controversial Hinckley Point C project, citing security concerns.

Under immense domestic pressure, May approved the project in September 2016. She also promised to reform the UK foreign investments regime in 2017 to permit greater scrutiny of foreign investments. This event and the debate it raised between those who seek the nation's fortune and those who protect the nation's security were the driving factors for this report. Indeed, Chinese state-owned companies have been investing large sums in the UK, and although their investments are warmly welcomed in a number of industries, it is unclear what part they play in China's larger economic strategy, and whether or not they act for commercial goals or for geopolitical ones. A spike in Chinese investment in critical national infrastructure and the UK's digital infrastructure have begun to raise concerns among the security services, tasked with protecting the secrets, information and resilience of the nation.

This report sets out to examine four different areas. First, to note the scope and nature of Chinese outbound foreign direct investment into the UK. Second, to attempt to understand the nature of China's state-owned enterprises and their place as agents of Chinese foreign policy. Third, to attempt to understand policies like Made in China: 2025 and how they drive China's investment in the West, including the UK. Fourth, to analyse various forms of review adopted by the UK's allies and European partners and to seek the model best suited to the UK's unique political and financial institutions, noting the close links between the City and Whitehall, and the primacy of Parliament. This report seeks to encourage a more transparent process of scrutiny of Chinese investments in critical areas, and to add the UK to the wider American–European shift on China, so that all states might encourage China to abandon its state-capitalist mercantilist strategy for a more liberal approach.
Chinese outbound foreign direct investment (OFDI) has rapidly increased over the past two decades from about US$1 billion in 1991 to $175 billion in 2016. Increasingly, China is shifting its OFDI strategy from an emphasis on resources and commodities in the developing economies to investing in high-tech, infrastructure and property in advanced economies. The United States, Australia and European economies are the recipients and beneficiaries of this new strategy. According to research carried out by the Mercator Institute for Chinese Studies (MERICS) and the Rhodium Group, Chinese OFDI jumped from US$130–140 billion in 2015 to approximately $175 billion in 2016. Global OFDI stock now exceeds $1 trillion. Chinese OFDI has tripled in only five years, and the country has become one of the world’s largest exporters of FDI, accounting for nearly 10% of global OFDI flow. Furthermore, Beijing is set to triple its offshore assets from $6.4tn (in 2015) to nearly $20tn by 2020, so much that China is moving to tighten capital controls.

In Europe, Chinese investment has surged from EUR 14 billion in 2015 to EUR 20 billion in 2016, a 44% jump. While Chinese investment is setting a record pace, this investment push does have its limits as China’s massive financial resources begin to max out and as Beijing begins to start to set controls on capital outflows, particularly among China’s private-sector investors. As Rhodium Group observes, this has led to the trend that “sovereign and state-owned companies are back in the driver’s seat”, accounting for nearly 60% of the value of deals from China.

### Chinese FDI in Europe Surges, while EU FDI in China Declines

**Value of FDI transactions between the EU-28 and China, EUR million**

<table>
<thead>
<tr>
<th>Year</th>
<th>Value of Chinese FDI in EU</th>
<th>Value of EU FDI in China</th>
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<tbody>
<tr>
<td>2000</td>
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<tr>
<td>2016</td>
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</table>

**Source:** Rhodium Group. Combined value of FDI transactions includes completed acquisitions resulting in ownership stake of 10 per cent or more and greenfield projects that have broken ground.

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January to June 2017. This contrasts with the investment push of 2016, which was led by China’s private sector. The Chinese state is still interested in OFDI, but it is increasingly interested in controlling the outflow as well as the inflow.

The OECD Regulatory Restrictiveness Index measures statutory restrictions on foreign direct investment in 58 countries, including OECD and G20 countries, covering 22 sectors. The 2014 FDI puts China last, next to Myanmar, Saudi Arabia and Indonesia. Such has been the criticism from foreign firms about China’s non-tariff barriers, that President Xi Jinping unveiled a long list of policy guidelines in his speech at Davos in January 2017, which were intended to “create an easier and more open and transparent business environment … to stabilize the scale and speed of foreign investment”. Despite claims by Xi that China would champion and lead globalisation, China remains an unfriendly environment for foreign firms, particularly in areas relating to national security. While there are some who argue that this might change after the Party Congress in autumn 2017, with President Xi promising deregulation on OFDI, there are others who view China’s long-term commercial strategy in more stark terms.

According to an influential report by the German think tank MERICS, China’s industrial strategy, Made in China: 2025, aims to turn China into a “manufacturing superpower” in the next few decades. While the provision of advanced technologies could be a hugely beneficial process for European and British firms, the report’s findings are alarming:

China’s leadership systemically intervenes in domestic markets so as to benefit and facilitate the economic dominance of Chinese enterprises and to the disadvantage foreign competitors … in essence, Made in China aims for substitution: China seeks to gradually replace foreign with Chinese technology at home – and to prepare the ground for Chinese technology companies entering international markets.

James Lewis, Senior Vice President at the Washington think tank, the Center of Strategic and International Security (CSIS), agrees with this analysis. Smarting from the “One Hundred Years of Humiliation” at the hands of Western “predatory capitalism”, Beijing has decided to avoid reliance on foreign technologies. Its overall strategy – Lewis suggests – consists of (1) creating a basic sanctuary for Chinese companies inside China, using non-tariff barriers to keep foreign competitors out, (2) subsidising Chinese companies and national champions so that they might compete in international markets, which will (3) enable Chinese companies to dominate certain sectors that relate to national security and high technology. If this perspective is correct, then Chinese investment into the UK’s economy might be motivated by a range of drivers, including a desire to improve its own military–industrial base and the need for key technologies it deems critical, in addition to gaining strategic influence within the UK’s domestic system. Whether or not this is in fact China’s global economic strategy is debatable, but there is some empirical evidence that it is happening.

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11 Interview, 6 July 2017.
12 Interview, 6 July 2017.
correlation between its behaviour and such a strategy, including the restriction of foreign investment into China, massive subsidies to Chinese national champions in key sectors, and centrally directed targeting of key technologies.

There is also growing awareness in NATO and other ally countries of the need for a coordinated approach towards national security reviews on investment into sensitive areas. Recent cases that have been raised include:

- The attempted acquisition of Germany’s Aixtron SE by Fujian Grand Chip Investment GmbH.
- The successful acquisition of Alcatel-Lucent Enterprise by China Huaxin Post and Telecommunication Economy Development Centre
- The successful acquisition of Kuka by China’s Midea Group
- The successful takeover of Norsat, a Canadian satellite communications firm with Department of Defense contracts, by Hytera Communications
- The successful takeover of walkie-talkie producer Sepura by Hytera
- The successful acquisition of Kuka by China’s Midea Group.

### Chinese Investment in the UK by Sector, 2016

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Energy &amp; Utilities</td>
<td>13%</td>
</tr>
<tr>
<td>Travel &amp; Hospitality</td>
<td>13%</td>
</tr>
<tr>
<td>Financial Services</td>
<td>23%</td>
</tr>
<tr>
<td>Technology, Media &amp; Telecoms</td>
<td>23%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>17%</td>
</tr>
<tr>
<td>Grain &amp; Sugar</td>
<td>3%</td>
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<tr>
<td>Healthcare</td>
<td>3%</td>
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<tr>
<td>Transport &amp; Logistics</td>
<td>3%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>3%</td>
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</tbody>
</table>

Source: Grant Thornton

Chinese Investment in the UK

The UK has become a significant destination for Chinese investment flows over the past decade. Indeed, only the United States, Hong Kong, Malaysia and Australia gained more Chinese OFDI in 2016. Chinese investors have sunk more than £29 billion into the UK since 2005, more than its investments in Germany, France and Italy combined. Despite these promising gains, more than 95% of net inflows to the UK have been in financial services, and according to *The Economist*, little of these impressive investment figures translate into growth. Nevertheless, gains for Chinese investors into the UK have been excellent, according to Grant Thornton, with an average of 174% returns for the best-performing 30 Chinese companies in the UK. With a combined turnover of £9.8 billion, three of these companies were in

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manufacturing; seven were in technology, media and telecoms; one was in leisure; four were in retail and consumer; six were in financial services; two were in construction; five were in energy and utilities and two were in business support services.  

"Chinese state-owned enterprises are arms of the Chinese state"

Dennis Shea, Chairman of the US-China ESRC, 2016

2. The Nature of Chinese State Capitalism

In considering the risks of Chinese investment in sensitive parts of the UK’s economy, it is necessary to ascertain to what extent Chinese investment is actually state directed in the UK. Much Western analysis on China’s state capitalist model attempts to distinguish between private Chinese companies and state-owned enterprises (SOEs). This is particularly evident in the United States where policymakers frown upon heavy interventions in the US economy by Chinese SOEs. Having said that, a considerable number of experts interviewed for this project argued that there is little or no real distinction between private companies in China and SOEs in the context of Chinese FDI abroad. According to Friedolin Strack, Head of Department of International Markets at the BDI, the German business association, “There is no distinction, nor should we seek to make one … for one thing, you never know their connections … for another, all Chinese companies have access to state finance through the large Chinese banks.” James Lewis at CSIS agreed, stating that while many Chinese companies are as motivated by commercial concerns as their Western equivalents, “the notion that a Chinese company can operate in China without following Chinese government direction is ridiculous.”

While SOEs only make up 5% of total enterprises in China, they control almost one-third of total enterprise assets owing to their large size. According to the State Department’s Office of Investment Affairs, there are approximately 156,000 SOEs, of which 54,000 are owned by the central government; the remainder are owned by local governments. Beijing directly controls 102 strategic SOEs through the State-owned Assets Supervision and Administration Commission (SASAC). According to the SASAC website, it “performs investor’s responsibilities, supervises and manages the state-owned assets under the supervision of the Central Government”, and undertakes any further tasks assigned by the State Council. Much of the outward investment discussed above has been facilitated by state banks like the Bank of China (BOC), the Export-Import Bank of China (CHEXIM) and the China Development Bank.

22 The term “Chinese companies” is taken to include those based in Hong Kong and Macau, since Tza Yap Shum v. Peru, a 2009 ICSID tribunal, held that a Chinese citizen from Hong Kong was entitled to claim damages under the Chinese Bilateral Investment Treaty with Peru.
23 Interview, 12 June 2017.
24 Interview, 6 July 2017.
Bank (CDB). The total lending of China’s state-owned banks exceeded the annual total lending by the World Bank and other multilateral development banks in 2011, evidence of Beijing’s deep pockets.

“China’s technology acquisitions are partly supported and guided by the state. ‘China pursues an outbound industrial policy with government capital and highly opaque investor networks to facilitate high-tech acquisitions abroad...in the long term, China wants to obtain control over the most profitable segments of global supply chains and production networks.’”


Aki Tonami, Associate Professor in International Relations and Economics at the Japanese University of Tsukuba, asserts that “while it is impossible to say that all Chinese SOEs are dangerous, it’s the lack of transparency and difficulty in accessing information31 that adds risk for recipients of Chinese OFDI. The opaque nature of SASAC’s control over SOE investment choices, the unclear ownership of controlling stakes in some companies,32 and the murky links between company CEOs and the Party officials make it extremely difficult – if not impossible - to distinguish between China Inc. and China CPC.33 In its 2016 Annual Report,34 the US–China Economic and Security Review Commission (ESRC) asserted, “Beijing continues to use SOEs as a tool to pursue social, industrial, and foreign policy objectives, offering direct and indirect subsidies and other incentives to influence business decisions and achieve state goals.”35 Furthermore, it is evident from the ESRC’s findings, and those of others, that under President Xi Jinping, the Chinese state is increasing – not decreasing – control over the economy, and while it has often debated reforming the SOE sector, it has in fact sought to consolidate state control and to pressure firms to act in line with government policy. Over the past decade, the European Commission (EC) has debated the issue of whether SOEs are to be viewed as constituting collectively one “economic unit”, when they fall under Central SASAC’s purview, noting that in the past common state ownership was not enough to spark concerns under the EU Merger Control Regulation. Despite going back and forth over this issue, the EC found in 2016, “Central SASAC does in practice have certain powers to involve itself in SOEs’ commercial behavior in a strategic manner.”36 By seeing them as one economic unit, the EC automatically bumped the turnover of China General Nuclear Power (CNG) above the minimum EU threshold for merger clearance ($281mn), which will create a type of assessment system for Chinese SOEs that attempt to purchase European energy companies.37

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33 The Communist Party of China.
“State owned capital investment operations must serve the needs of the state, invest in more key industries and areas that are vital to national security and are the lifeblood of the economy”

Decision of the Central Committee

The Increasingly Centralized Nature of Power under Xi Jinping and the Party

Perhaps the most salient feature of contemporary China under Xi Jinping is the fact that he has amassed more power than any previous leader other than Deng Xiaoping and, perhaps, the father of Chinese Communism, Mao Zedong. In the wake of Deng’s 1980 speech, ‘On the Reform of the Party and State Leadership System’, China’s leaders sought reforms that would decentralise power and “collective leadership”, codified by the principle of decision-making by consensus among the CPC’s Politburo and Politburo’s Standing Committee. Scholars of Chinese domestic politics, such as Sangkuk Lee and David Lampton, have tracked the normative and institutional changes implemented by Xi in his rapid rise to power. Rather than being one of China’s most restrained leaders - as some predicted - Xi has accumulated much power through the creation of new small working groups, using various ideological prompts, including neo-Maoism and the “China Dream” of national rejuvenation, to ensure the purity and survival of the CPC. His anti-corruption campaign - while judged to be authentic in its motive of cleaning up the party cadre - has also been used to attack and remove senior leaders who might challenge his power base. Worryingly, there has been a return to Maoist-style ideological orthodoxy, an open hostility to Western Enlightenment-era ideals, and a centralising of military, media and state functions to the CPC and to Xi personally. The stress on humiliation at the hands of foreigners - a narrative promoted by many state organs at the moment - creates an ambiguity among Chinese about the international system of rules. As can be seen by China’s approach to the Permanent Court of Arbitration’s July 2016 ruling on the South China Sea and its unilateral withdrawal from the Sino-British Joint Declaration of 1997, Beijing is increasingly confident about reneging on what it sees as unfair international laws and norms - written when China was weak. Thus, any confidence that Beijing would not misuse its investments in Britain’s national infrastructure for its own national interests may be misplaced.

Understanding in the West of these changes inside Xi’s China lag far behind the consequences of allowing Chinese investors into sensitive parts of Western critical national infrastructure. As the recent shift in German investment law indicates, there is however a growing debate

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taking place over how to view China’s business community in terms of this shift in power at the heart of the Chinese system. It is as if there is a type of blindness when it comes what impact an increasingly-authoritarian Chinese state has on Chinese companies and Chinese investment. There are signs, however, that Xi’s centralisation is now extending to China’s business community, many of whom operate or own China’s largest private companies. Signs of this unequal power struggle can be found in a number of odd episodes, including the arbitrary arrest and detention of Xiao Jianhua, a financier with links to the Xi family, from his Hong Kong hotel.47 While many in the West have linked these arrests to Xi’s corruption crackdown, there is a level of duality to these charges, and one might surmise that Xi’s crackdown is also driven by his quest to centralise power. Their arbitrary nature over some of China’s richest businessmen, might parallel Vladimir Putin’s initial struggle over Russian oligarchs. Other Chinese billionaires who have fallen foul of Xi include Guo Wengui, a real estate mogul who has fled abroad, and Xi Ming, a close associate of former Chinese senior party official Bo Xilai.48

While many in the West are gradually becoming aware of these changes, there has been a lag among those government departments that are expert in trade, who have yet to understand what Xi’s centralisation of China Inc. means for investment in sensitive parts of the economy. Conversely, Western companies and governments who do business inside China are increasingly aware of how much things are changing under Xi. Western multinationals have begun, according to Bloomberg, to shift their lobbying of state officials to party officials and party groups affiliated with Xi. The Conference Board research group, which counts 1,200 members as clients, including Nestle SA and Walmart Stores Inc., notes “the changing dynamic of party-state relations”, and asserts, “As the Communist Party of China takes an increasingly active role in policy design and implementation, multinational companies need to think anew about government affairs strategies.” This shift, Bloomberg asserts, comes as “Xi has reasserted the party’s supremacy – with himself as its ‘core’ leader – over everything from executive functions to state-owned enterprises to the 3,000 member National People’s Congress meeting that wraps up this week in Beijing”.49

**Risks Associated with Investment from China’s State-Capitalist Model**

While China’s leaders have been quick to point out the positive contribution of Chinese OFDI to the global economy, and while most host economies in Europe – including Britain – openly welcome Chinese investment, this report notes that, in light of China’s increasingly authoritarian state-capitalist system, there are aspects relating to national security that require more consideration than they have hitherto received. One American scholar, Theodore Moran, argues that the Committee for Investment into the United States actually deals with three threat types: first, the leakage of sensitive technologies to a foreign power; second, the ability of a foreign power to block, delay or restrict output from recently acquired American companies; and third, the potential ability for a foreign power to penetrate a US company or part of infrastructure in order to conduct surveillance or implant destructive malware.50

This report, in attempting to build on the threats identified by Moran, puts forward the following: (i) the lack of investment reciprocity; (ii) imbalances caused by China's massive state-owned enterprises; (iii) the monopolistic control of strategic industries; (iv) the geopolitical nature of China's investment portfolio, and underlying exchange of investment for influence within a given state; and (v) the security and public safety issues raised by Chinese ownership.

i. The lack of investment reciprocity. Many of the strategic markets in which China is investing in the UK and Europe – such as energy and infrastructure – remain closed in China to EU or UK investors. The OECD FDI Index still regularly ranks China as one of the most restricted environments for FDI, with high entry barriers, and while there are signs that an EU-China Bilateral Investment Agreement might address such imbalances, current trends are not hopeful. In 2014, a US-China Business Council survey found that competition from domestic competitors was the primary restraint on increased profitability among US firms in China at 31 per cent, rising costs ranked 26 per cent, while government regulation ranked at 21 per cent.

ii. Imbalances or distortions caused by investments or acquisitions by Chinese state-owned enterprises, who accounted for 62% of China's European-bound investment in 2014 and 70% in 2015. Some have argued that access to low-interest state loans and subsidies mean that there is effectively little difference between a Chinese "private company" and a Chinese "state-owned enterprise". According to the Grant Thornton Tou Ying Tracker 2016, the Bank of China facilitated acquisitions in 188 global deals by extending $56.3 billion worth of loans to Chinese companies between 2010 and 2016.

iii. Monopolistic control of strategic industries by purchasing European high-tech firms with key intellectual property and then out-competing non-Chinese competitors, again with either state subsidies or low-interest loans. The development of China's monopoly in solar and PV installation came after Beijing supplied more than $47 billion in subsidies, effectively destroying many European and American competitors by undercutting them in pricing. Ken Zweibel, an expert in the US solar industry said, "If there was ever a situation where the Chinese have put their whole government system behind manufacturing, it's got to be solar modules ... they think they can wipe out all the competition in the world." While the quote is a strong one, the fact that Zweibel is a sector expert indicates the depth of feeling within the solar panel industry.

iv. The geopolitical nature of China's investment portfolio, and underlying exchange of investment for influence within a given state. With its command economy, Beijing is able to direct the investment flows of its SOEs - and increasingly its private corporations - for geopolitical or strategic leverage. As Greece's recent veto of an EU statement on China's human rights record shows, Chinese investment can be used by Beijing to weaken common negotiating positions within the EU-28 on diplomatic and human rights issues. From a Chinese perspective, the UK is an attractive target since it is a close defence and intelligence ally of the United States, its main peer competitor in the Asia-Pacific region. As with its use of investment in Laos, Cambodia and Greece, Beijing will want to stay the UK's hand in any future contingencies involving the United States, such as a Taiwan or South China Sea incident. It has demonstrated

53 Ibid., p.5.
54 Interview with German BDI official, Friedolin Strack, 13 June 2017.
57 While it is recognised that the UK is unlikely to become involved in contingencies involving the US and China over Taiwan and the South China Sea, Washington would pressure the UK government and its other allies for some economic sanction response, something Chinese investment may counter.
an easy willingness to use non-WTO means to push other states over geopolitical issues: this ranges from the blocking of rare earth metals to Japan in 2010\textsuperscript{58} and banning Philippines bananas in 2012\textsuperscript{59} to stopping tourism to South Korea in 2017.\textsuperscript{60}

"Foreign direct investment is fine, no doubt, as long as it's not being used as a Trojan horse to try and influence our foreign policy."

Sir Gerald Howarth

v. Security and public safety issues raised by Chinese ownership. China’s investment surge into parts of the UK and European national and digital infrastructure has wider implications for security and public safety. This is partly because Chinese firms are gaining physical access to key parts of the communications system used by the state, and key technologies upon which British and European security agencies and militaries depend.\textsuperscript{61} The potential purchase this year of Arqiva, the UK’s main mobile phone and television mast company, by a Chinese consortium led by Li Ka Shing of CKI, are but one example\textsuperscript{62}. Gaining access to the UK’s high-tech industry may open access to key future technologies, while accessing important components of the digital infrastructure may open access to the intelligence of the UK or its allies. Furthermore, the fact that Chinese state-owned companies might through investment gain access to large amounts of personal data of UK citizens presents risks. Such data could be mined by Chinese intelligence services in a bid to seek to influence key policymakers or public figures, threatening exposure or blackmail. The June 2017 cyberattack on Parliament\textsuperscript{63} and the June 2015 attack on the US Office of Personnel Management may have been carried out for such long-term influencing campaigns. While attacks seem to be difficult to stop, they are at least irregular, detectable and, at times, preventable. Chinese ownership of, control of or access to a part of the UK’s digital infrastructure would make access regular, undetectable and unpreventable.

"In today’s technology-driven world, the intelligence requirements of a number of countries are wider than before. They now include communications technologies, IT, energy, scientific research, defence, aviation, electronics and many other fields. Intelligence services, therefore, are targeting commercial as well as government-related organizations. They sometimes do this on behalf of state-owned or sponsored companies in their own countries."

“Targets of Espionage”, MI5 website


\textsuperscript{62} Christopher Williams, “Foreign investors circle British mast owner Arqiva”, The Telegraph, 1 April 2017, available at: http://www.telegraph.co.uk/business/2017/04/01/foreign-investors-circle-british-mast-owner-arqiva/

While the robustness of the United Kingdom and its high-technology products are the most likely drivers for Chinese investment, there are risks that should be taken into consideration. After all, the United Kingdom has an advanced defence industrial base, which would be an attractive target for states intent on leapfrogging up the defence technology ladder. Geopolitically, it is one of the closest treaty allies of the United States, China's main peer competitor in the Asia-Pacific region. Owing to this and other factors, the UK by extension becomes an attractive target for Chinese espionage. The United Kingdom's place as a Five Eyes member, and its consequential sharing of intelligence and sensitive military technology with the United States, cannot be discounted as a possible draw for Chinese 'malicious investment'. The 2016 Annual Report to Congress of the US–China Economic and Security Review Commission asserts, “To the extent that the United States has shared military technology, weapons, and weapons systems, and operational plans with these countries, China's infiltrations of their defense establishments could compromise US national security.”

The United Kingdom's record of supporting the United States in military conflicts, the closeness of their intelligence and security communities, also mean that Chinese strategy may wish to nullify the United Kingdom as an active and supportive partner to Washington.

The risks involved in these three areas – manufacturing; technology, media and telecoms (TMT), and energy and utilities – are varied and should be examined closely with regard to their relevance to state security.

Manufacturing

While manufacturing would appear to be the most innocuous of these three areas, it should be noted that both Precision Components and Holroyd Precision – two companies sold by Precision Technologies Group to a Chinese SOE, Chongqing Machinery and Electric Company (CMEC) – manufacture machine tools. Machine tools are the foundation of an industrialised economy, and are necessary in the manufacture of a range of sectors, including white goods, automotive, medical and electrical. They are also necessary in the manufacture of aerospace and defence platforms and armoured systems, such as fighter aircraft and tanks. Thus, many machine tools are considered dual-use technologies, and are restricted or embargoed by various export control regimes, under the UK’s commitments and obligations to observe UN, EU or OSCE arms embargoes. These tend to be for those that have extreme accuracy in milling, measuring or finishing of hardened materials, those that deal with composites and those that have “contouring control” in two or more axes. While there has long been trade with China in the machine tools industry, the fact is that without them, advanced fighting platforms – such as fifth-generation aircraft with their composite surfaces – would be impossible to build. Thus they play an important role in allowing Chinese intelligence efforts to attempt to create those system designs that they manage to steal through cyber-espionage.

“You can’t really separate cyber from anything ... everything is connected ... whether your enemy bombs your servers, puts a digger through your cables, or attacks your networks. And it’s virtually impossible to separate cyber from anything, particularly from critical infrastructure, which is why everyone is worried about it.”

Jennifer Cole – Senior Research Fellow, RUSI

Technology, Media and Telecoms

This is perhaps the most dynamic and challenging area for locating and managing elements of risk brought on by Chinese investment. MI5’s website notes that foreign intelligence services are particularly “interested in communications technologies, computers, genetics, aviation, lasers, optics, and electronics. Such secrets may also help give some countries an economic or military advantage.”70 The issue was first brought to national prominence in 2007, after Jonathan Evans, the head of MI5, wrote a letter to 300 chief executives warning them about Chinese cyberhacking.71 One example of the seriousness of Chinese cyber-espionage has been the so-called Byzantine Hades hacks, the code name given by US investigators to a series of attacks by the Chinese People’s Liberal Army, which stole more 50 terabytes of information (said to equal five Libraries of Congress) on the subjects of the B-2 stealth bomber, the F-22 jet, space-based lasers, missile navigation and tracking systems, as well as nuclear submarine and missile designs. China’s newest stealth fighter, the J-31, is said to have incorporated much of the technical data from the F-35, including radar design and engine schematics, among other things. Lin Zuomin, the Chairman of the Chinese defence firm AVIC, boasted, “the J-31 will finish it [the F-35] off in the sky.”72

BT agreed that Huawei – a Chinese telecommunications firm with origins within the PLA – would supply components for BT’s upgrade of its infrastructure. Despite a warning by MI5 that malicious coding would be “very difficult to detect or prevent”,73 giving Chinese backdoor control in the Huawei components to intercept or disrupt BT traffic, the deal passed, largely over financial considerations. The centre charged with checking components in Banbury, Oxfordshire, though overseen by British citizens, is technically run and paid for by Huawei, showing the balance between commercial interest and national security.74 Since then, British communications and high-tech firms have continued to be snapped up by Chinese investors or consortiums. The risks vary, as befits such a complex and constantly growing sector. They include ownership of or access to sensitive intellectual property that is pertinent to UK security. They also include ownership of the actual data centres that house information.

The recent purchase of Global Switch, one of the UK’s largest companies, provoked Lord West, a Labour Peer, to say, “I have a nervousness about the Chinese getting more and more involved in large chunks of our digital infrastructure.”75

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In response, a spokesperson from Global Switch’s parent company, Aldersgate Investments Limited, insisted, “Global Switch will continue to provide highly resilient and secure data centre space which complies with the guidance issued by the UK Government Centre for the Protection of National Infrastructure as part of the UK Government’s national security strategy.”

**Energy and Utilities (Infrastructure)**

The primary risks of foreign state-owned enterprises accessing the UK’s critical national infrastructure are twofold.

First, those states may be able to control or deny service to those infrastructures, either through backdoor systems or through semi-legal means. The fact that China might be able to hack a nuclear power station does not mean that there are no risks in putting China in charge of one. A sophisticated intelligence agency would be able to invent or create cover stories about technical difficulties in ways that might be difficult to argue. Certainly, if such episodes were to take place with massive media messaging inside the UK’s national media, the government might find itself on the defensive and unable to reassert control over a critical component of the UK’s grid. Still worse, a foreign power might be tempted to interfere with energy prices during the winter to weaken one political party over another. A winter of discontent – with high energy prices – might help a friendlier political party move from opposition to power.

Second, there is the very real problem of political influence inside the UK’s government, particularly with regard to Chinese SOE investment. With its unparalleled ability to leverage future promises of investment and even scale down those in existence, Beijing increasingly develops the foreign policy choices of the United Kingdom. As has been raised already, China’s recent massive investment into Greek ports, followed by Athens’ veto over a European Union report on human rights inside China, reveals that China is not shy about using this influence when it wishes.

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4. Case Studies

i. Case Study: Hinkley Point C (Energy and Utilities)

In the wake of the French–British summit of February 2012, David Cameron and Nicolas Sarkozy announced the Hinkley Point C expansion project. Hinkley Point is a nuclear power plant located in Somerset, South West England, and consists of two units: Hinkley Point A, which was permanently shut down, and Hinkley Point B. The Hinkley Point C project consists of the building of two additional European Pressurised Reactor (EPR) power plants by the French state-owned company Electricité de France (EDF). The twin reactors planned for the Somerset site would be the first new nuclear plant to be built in Britain for more than 20 years. In the wake of significant difficulties in the financing of this project, Jean-Bernard Levy, CEO of EDF, signed a deal in October 2015 to bring in China General Nuclear (CGN) and China National Nuclear Corporation (CNNC), who committed to fund 33.5% of the project. As part of this deal, Beijing obtained the right to build later two more power plants in Sizewell and, most importantly, the right to build its very own, 100% Chinese, third-generation reactor in Bradwell, called “Hualong”, which means “dragon”.

In many ways, Hinkley Point C was a key part of the Osborne doctrine: the former Chancellor of the Exchequer was the architect of the “golden era” of Sino-British relations and drove a policy of openness towards Chinese investments. Liberal Democrat former energy secretary Sir Ed Davey later claimed in the national media that Osborne had overruled extra safeguards in the project. Following the Brexit vote and Theresa May’s subsequent rise to power, Hinkley Point was subject to fresh scrutiny from the new Prime Minister, who is arguably more cautious than her predecessors when it comes to Chinese investments in sensible infrastructures. Ms May announced in August 2016 that British government approval of the project would be delayed owing to the need of additional review. This decision sparked fierce reaction from China, with Liu Xiaoming, the Chinese Ambassador in London, publishing an article in the Financial Times stating that the China–UK relationship was at a crucial historical juncture and that the deferral imperilled the relationship. He urged London to approve Hinkley as soon as possible and expressed a hope that “the UK will keep its door open to China”. Nonetheless, the project was finally green-lighted two months later, but under revised conditions on the investment scheme: EDF has now been barred from selling its stake in the plant during construction and will maintain industrial control over the project; meanwhile the UK government would take a “golden share” in future nuclear schemes.

Since the very start, this £18 billion project has sparked controversy. While many heavily criticised the UK government’s decision to choose nuclear energy to cut their carbon emissions instead of safer and greener renewable energies, others were more concerned about the financial aspects of the deal. Mr Thomas Piquemal, former Finance director of EDF, quit his position and spoke in front of the French National Assembly to denounce the financial risks linked to Hinkley Point, arguing that EDF does not have the ability to fund the project over the short term. Moreover, the British government is to pay £92.5 per megawatt-hour of electricity produced from Hinkley Point for the next 35 years. This is almost twice as much as the current market rate.

and leaked government data exposed that this deal could cost Britain's taxpayers up to £30 billion. In addition to these worries, many were concerned with security risks raised by the heavy profile of a Chinese state-owned enterprise investing in UK critical national infrastructure.

**Security risks of the Hinkley Point C project**

While security experts and politicians have raised concerns over the national security threats regarding CNNC and CGN involvement in Britain's nuclear infrastructure, it is difficult to accurately assess the risks. This is partly because of the technical aspects behind the deal, and partly because it is not clear whether Chinese involvement in the construction of Hinkley Point will be any more dangerous than the vulnerability of the site to Chinese hacking. Agatha Kratz at ECFR stated, 'shutting down Hinkley point would surely disrupt, at least temporarily, electricity supply in the country – and could cause electricity prices to go up. But unless China and the UK are in an open conflict situation, that would be extremely costly for Beijing and CGN both financially and in terms reputation.' Furthermore, the additional conditions imposed on the deal itself – barring EDF from selling the majority stake to the Chinese – indicate that it would be difficult for China to exert control over the plant itself in any legal way. Nick Timothy’s assertion that the involvement of China’s largest nuclear powers CGN and CNNC might allow them to “shut down Britain’s energy at will” remains difficult to prove. Regarding these counter-arguments, China’s SOEs are unlikely to weigh reputational costs more highly than national interests, and under pressure from Beijing, would swiftly carry out whatever tasks were set for them. If the UK and China were to come into diplomatic conflict over Chinese repression in Hong Kong or a contingency relating to Taiwan, London might find Hinkley Point a critical vulnerability, since Beijing would weigh its own sovereignty-related interests more highly than reputational concerns.

On the other hand, there is another risk – quite apart from backdoor vulnerabilities – which might be considered, involving political influence of a foreign power over certain business sectors that help the UK to protect and manage its citizens. The acceptance of Chinese capital by a grateful Treasury seemed to give China access to senior officials inside Whitehall, quite apart from those investments in less-important sectors. One of the most distressing points about the Hinkley Point debate in the summer of 2016 was the ability and willingness of the Chinese state to exert political pressure on a debate internal to the UK. The Chinese Ambassador wrote a leader in the *Financial Times* in which he implied that unless the deal went through, other investments and business deals could be affected, demonstrating Beijing’s willingness to exert strong pressure on a domestic issue in a way that few liberal democracies are able to. Neither the government nor those in the security services were able to respond in quite the same way, nor were the Ambassador’s articles challenged in any meaningful way by the newspapers themselves. The state media, *Xinhua*, stated, “After divorcing the EU, Britain would be foolish to decline stronger trade ties with China ... While contemplating whether to give the program a go-ahead or not, London needs to fully appreciate the gravity of what's at stake.”

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83 Interview with author(s), 1 June, 2017.
86 With the exception of sanction threats, which are fairly rare between states with heavy trade ties.
87 Though it should be noted that the *Financial Times* published a letter eight days later by David Lowry, a senior research fellow at the Institute for Resource and Security Studies in Cambridge, Massachusetts.
The fact that both CGN and CNNC are state-owned enterprises should itself be of concern since they are subsidised parts of the Chinese state, immune from market pressures. A CGN senior engineer, Allen Ho, a China-born US citizen, was charged of nuclear espionage in August 2016, indicating that the company had worked closely with Chinese intelligence agencies in pursuit of China’s national security objectives.\(^8^9\) Ho and Energy Technology International allegedly conspired between 1997 and April 2016 to engage in the development and production of special nuclear material in China. The fact that this incident came to light at the very same time the UK government was reviewing Hinkley Point, but somehow failed to make a dent on the momentum for the project, reveals the danger of having a review process that is overly political. Lacking an institutionalised procedure to act as a firewall to protect the government from undue pressure, May’s Cabinet was swiftly isolated over the incident from inside her party, from business interests, and from a foreign state threatening to cut off future investment. While it is possible to argue that China’s campaign over Hinkley Point was the exception rather than the rule, it stands as evidence that despite China’s long-held principle of noninterference in the domestic affairs of other countries,\(^9^0\) China is quite willing to pressure states into accepting Chinese investment when it wishes to do so.

**Findings**

- The need for a fully politically independent committee reviewing foreign investments in the UK is essential to avoid foreign pressure and/or lobbying.
- When it wishes to, China is willing to tie future “investment packages” to objectives it feels strongly about, leveraging its FDI in ways that few liberal democracies can resist in today’s economic climate.

**ii. Case Study: Global Switch (Technology, Media, and Telecoms)**

Global Switch is the London-based parent company of Aldersgate Investments, which provides cloud neutral data centres in Europe and in the Asia-Pacific region. The firm operates in Amsterdam, London, Paris, Madrid, Frankfurt, Hong Kong, Singapore and Sydney, with a combined space of 3.2 million square feet. It is Britain’s largest data centre and the world’s second-largest wholesale data centre provider.

In September 2016, reports emerged concerning the potential sale of a 49% stake of Global Switch to a Chinese consortium. As data centres often hold sensitive information for financial institutions, governments and telecoms groups, politicians and security experts immediately raised concerns over the potential selling of a UK data centre to Chinese state-owned companies. Global Switch was quick to quash these national security concerns by arguing that the company had no access to its customers’ data and did not provide IT services.

In December 2016, the Elegant Jubilee Chinese consortium agreed to pay £2.4 billion for the 49% stake in Global Switch.\(^9^1\) The Chinese consortium of 12 was assembled by Li Qiang, President of Daily Tech, and includes Jiangsu Sha Steel Group, AVIC Trust, Essence Financial, Ping An Group and Daily Tech. Indeed, Mr Li and Geoffrey Xu (Managing Director, Head of China Investment Banking, Daiwa Capital Markets Hong Kong Limited) are now representing...
Elegant Jubilee Limited on the board of the Company. According to a Global Switch press release, John Corcoran, the company's Chief Operating Officer, and the existing management team will continue to manage the day-to-day running of the company. The new investment is expected to finance the strategic infrastructure expansion of Global Switch, as the company plans to intensify its support for Chinese telecommunications and internet services companies. Simultaneously, Global Switch announced major pre-commitments from China Telecom Global “though service agreements with Daily-Tech” for capacity at their new data centres in Hong Kong and Singapore.

In the wake of this transaction, and in accordance with the aforementioned precommitment, China Telecom Global (CTG), Daily Tech and Global Switch signed a “game-changing” deal on 25 April 2017 to cooperate on expanding into new markets and jointly provide a data centre, network and systems integrations services. According to David Reuben, “On a global scale, [this partnership] will enable the expansion of Chinese companies overseas in close step with China's ambitious belt and road initiative.”

Security risks of the Global Switch purchase

As soon as the reports speculating on the sale of Global Switch's stakes to a Chinese consortium emerged in September 2016, security experts and government officials raised national security concerns over the potential deal. Sir Malcolm Rifkind, former foreign secretary and chairman of the UK Parliament Intelligence and Security Committee, was among them, and urged Theresa May to impose a strict scrutiny on the deal, saying, “The government needs to be satisfied there are no risks involved.”

While Global Switch downplayed the matter in a press release in the wake of these statements, saying it does not provide any IT and cloud services and therefore has no access to customer data, there are a few major issues worthy of examination. The consortium that carried out the deal does have strong links to China's defence industry. While the primary driver was Jiangsu Sha Steel Group, China's largest steel company, a secondary member of the consortium was the asset management company AVIC Trust. Partowned by AVIC Capital, both are in fact subsidiaries of one of China's largest defence aerospace SOEs, the Aviation Industry Corporation of China (AVIC), headquartered in Beijing. Similar to Boeing, the firm makes both airliners and jet fighter aircraft. Unlike Boeing, it owns a large number of other aerospace national giants, including Harbin Aircraft Industry Group, Chengdu Aircraft Industry Group, and Xi'an Aircraft Industrial Corporation. It also owns a number of non-defence companies, some of which carry out financing of China's aerospace sector. Lin Zuomin, Chairman of AVIC, is a member of the eighteenth Session of the CPC Central Committee. In other words, the heart of China's defence industry just bought a major data centre in the UK and no one seems to have noticed. It is odd that this has not been raised in any British media reports or in government discussions about the purchase.

This may be because few civilians are aware of AVIC and would not know its connection to China's defence industry. Given the impenetrability of China's huge companies, it is unsurprising

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that this was not noticed by many in the high-tech industry. Regardless of the reasons for this omission, it is clear that one Five Eyes member, Australia, did not view the transaction favourably. In June 2017, the Australian government filed to move out of the Global Switch data centre and to terminate its contract with Global Switch by 2020, citing the change in ownership. The shift will cost $151 million to move its secret files back to the government once the contract expires. Reports indicate that the change of ownership following the cash transaction in December triggered a Foreign Investment Review Board (FIRB) investigation, which led the government to impose strict fresh conditions, one of them being that the Australian branch would have to be 100% owned and operated by Aldersgate Investments. This move clearly underpins the existing security issues linked to the Global Switch sale, as well as what appears to be a blatant lack of oversight by the British government for the interests of a close ally and fellow Five Eyes member. The question that should be uppermost in the minds of the Home Office is whether Global Switch services any branches of the UK Armed Forces or security services, and to what extent a buy-in by a major Chinese defence industry subsidiary is a more systemic risk.

**Findings**

- While the Global Switch press release notes the presence of AVIC Trust in the Chinese consortium, it does not explicitly note that this company is jointly owned by AVIC Capital, a financing firm for one of the largest Chinese defence industrial state-owned enterprises.
- It is not clear that the UK review process included the interests of Australia, a close Five Eyes ally, and given the institutional coordination and intelligence-sharing between the UK and Australia, this also risks UK intelligence and interests.

### iii. Case Study: CK Hutchison Holdings (Critical National Infrastructure)

Our third case study for a Chinese investor in the United Kingdom is CK Hutchison Holdings Limited. In 2015, Hong Kong businessman Li Ka Shing, the former chairman of both Cheung Kong (Holdings) and Hutchison Whampoa, managed to restructure his business empire by merging Cheung Kong (Holdings) with its main associate company Hutchison Whampoa to create CK Hutchison Holdings. It is headquartered in Hong Kong but incorporated in the Cayman Islands with limited liability. CK Hutchison Holdings currently employs more than a quarter of a million employees in more than 50 countries. In 2016, CK Hutchison Holdings Limited reported a turnover of about $48 billion for that year. It invests mainly in ports, retail, infrastructure, energy, telecommunications and finance. CK Hutchison’s Infrastructure Division invests in energy, transportation and waste management. It has a 75.67% interest in CK Infrastructure Holdings Limited which is present mainly in the United Kingdom, Australia,

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101 Ibid.
102 Ibid.
CK Hutchison Holdings has invested heavily in the United Kingdom and is spread across a range of sectors. Around 36% of CK Hutchison’s revenue before earnings and taxes in 2016 were from Britain.109 In the UK, CK Hutchison Holdings owns the telecommunications company Three which provides 3G and 4G services. Hutchison Port Holdings Limited (Hutchison Ports) owns four ports in the United Kingdom: Harwich International in Essex, Harwich International (Cruise Terminal) in Essex, London Thamesport in Kent, and Port of Felixstowe in Suffolk.110 Felixstowe is a huge asset since it is the biggest and busiest container port in the United Kingdom and is strategically important because it "provides some of the deepest water close to the open sea of any European port."111 CK Hutchison also holds a 75.67% interest in CK Infrastructure Holdings Limited, which has invested in extensive infrastructure in the UK,112 including Northern Gas Networks Limited, UK Power Networks Holdings Limited, Northumbrian Water Group Limited, Wales & West Gas Networks (Holdings) Limited, and Seabank Power Limited.

Security risks of CK Hutchison Holdings

In 2014, the Chairman of CK Hutchison, Li Ka Shing, became the second largest shareholder by buying 450 million shares of AVIC International Holdings. This commercial airline producer is another subsidiary of the Aviation Industry Corporation of China (AVIC), the defence aerospace giant that straddles China’s defence industry. The relationship between Li Ka Shing and the Chinese state illustrates the murky connections between private companies and the Chinese state. It is at times difficult to tell who is working for whom. However, a brief survey of Li Ka Shing will certainly prove his very close political connections to the highest ranks of the Chinese state, although, as this assessment will make clear, this has waned under President Xi Jinping.

Li Ka Shing has enjoyed close relationships with leaders of the CPC in the past, and his connections with Beijing are well known to the public.113 He was an advisor to and a close friend of Deng Xiaoping and a confidant of Jiang Zemin.114 Li Ka Shing was an important advisor during the talks between the British and Chinese that led to the Sino-British Joint Declaration.

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105 Ibid.
on Hong Kong’s future, which was signed into place by Zhao Ziyang and Margaret Thatcher in 1984. During the years between 1985 and 1990, Li Ka Shing served as a member of the Drafting Committee for the Basic Law of the Hong Kong Special Administrative Region. Additionally, he served on the board of directors of CITIC, the PRC’s investment arm. Li Ka Shing is also known to have relationships with President Jiang Zemin, Premier Zhu Rongji, President Hu Jintao and Prime Minister Wen Jiabao. In 1997, Li Ka Shing’s Hutchison Whampoa signed 25-year leases on ports at both ends of the Panama Canal through its subsidiary Panama Ports Co. A Defense Intelligence Agency (DIA) report from 22 April 1998 viewed Hutchison Whampoa as a proxy for the Chinese state, noting that Li received heavy Chinese funding for his bid. While these allegations are old, the history of Li Ka Shing’s dealings since are illuminating.

Although in the past Li Ka Shing’s companies have served Chinese strategic interests, the current relationship between Beijing and Li Ka Shing has recently become more tumultuous. Difficulties began in 2012 when Li acted against Leung Chun-ying, Beijing’s replacement of the chief executive of the local HK government. Although Li Ka Shing was close to former Presidents Jiang Zemin and Hu Jintao, his relationship with Xi Jinping has not been as stable. In 2015, Chinese state-controlled media, such as the People’s Daily, criticised Li Ka Shing harshly. These outlets questioned Li’s loyalty and accused him of being ungrateful, since the CPC’s policies and “opening up” were a huge key to Li’s success. Eventually Li responded with a statement reviewing his extensive investments in China and expressing his respect for Xi Jinping. One way of understanding this apparent battle is to suppose that Xi’s attempts at centralising party and state control over China’s economic and corporate interests have been far more considerable than those of his predecessors.

Perhaps Li Ka Shing’s initial reaction was to attempt to maintain some measure of control over his vast business empire, before realising the costs. He is due to step down within the year, and the business tycoon’s son, Victor Li, has been named as his successor. Victor Li’s political involvement and affiliations are difficult to measure, but he has long been an active member of the National People’s Congress. While such affiliations might well be for lobbying purposes, it is unclear how these bodies will move in Xi’s increasingly centralised economy. Thus, Xi Jinping may well be on his way to informal but direct control over three of the UK’s largest ports and a large segment of its gas and water critical infrastructure. Given the fact that these changes might make CK Hutchison Holdings an informal but direct agent of the Chinese state, the Home Office and security services should review those contracts in order to maintain the security and resilience of the UK’s national security.

116 Ibid.
119 Ibid.
121 Ibid.
Findings

- The Communist Party uses Hong Kong companies like Hutchison to mask its involvement and interest in deals that have great strategic and infrastructural import.
- A Hong Kong company with strong ties to the Chinese defence sector – AVIC – and the CPC have control of three of the UK’s largest ports and some of its gas and water infrastructure.
- The recent falling out of Li Ka Shing and President Xi Jinping may point to a power struggle between the CPC and private Chinese and Hong Kong-Chinese companies.
- If this is true, there is a high chance that companies like CK Hutchison will begin to behave more like formal SOEs in the future and closely pursue state policy objectives.

The UK’s official definition of CNI is:

“Those critical elements of national infrastructure (facilities, systems, sites, property, information, people networks, and processes) the loss or compromise of which would result in major detrimental impact on the availability, delivery, or integrity of essential services, leading to severe economic or social consequences or to loss of life.”

The Centre for the Protection of National Infrastructure
In the wake of Hinkley Point C nuclear project's approval in September 2016, Theresa May announced a government consultation in 2017 to review and reform the existing policy on foreign investments in the UK. The British government is set to adopt a regime allowing greater political intervention in the foreign investment environment. As of now, and unlike the US, Canada or Australia, the UK lacks a single dedicated body to scrutinise foreign investments, but instead relies on a number of rather different legislative mechanisms which authorise the government to intervene in specific situations. Two pieces of legislations regulate foreign investments in the UK.

**The Enterprise Act 2002**

This Act grants a specific power of intervention to the government in industries deemed to be of special importance to the government. The government can issue a prohibition order if it considers that changes of control within such companies are likely be contrary to national interests, plurality of the media, commercial competition, or contrary to the stability of the UK's financial system. The government can consequently block a potential transaction or impose conditions on the progress of the deal through the Secretary of State, who issues a public interest intervention notice. The Competition and Markets Authority (CMA) then conducts a review in a Phase 1 process, usually in fewer than 40 working days. If the commercial entities wish to proceed without making undertakings, the CMA takes a further look at the deal, taking 24 weeks, with a possible extension of 8 weeks. While The Enterprise Act 2002 passes authority over the control of mergers and takeovers to the CMA and to the European Commission for large scale EU dimensional operations, the government can still intervene in any merger investigation, provided it can raise public interest grounds, by issuing an intervention notice. The Secretary of State can also overrule the CMA if it believes that national interests are more significant than concerns about monopolies. This was the case of mergers between defence industries and financial services after the Financial Crisis in 2007-8.

**Golden shares**

Golden shares are nominal shares that give the holder veto power over changes to the company's charter, as well as the ability to block a takeover or acquisition by another company. Therefore, golden shares allow the government to control changes in ownership of a small number of companies operating in the defence and infrastructure sectors.

However, their use is only permitted on a small number of companies and on narrowly defined grounds such as public security, national security and defence. Furthermore, golden shares are in prima facie contradiction with the European law of freedom of movement of capitals and freedom of establishment, and have been deemed illegal by the European Court of Justice in a large number of cases. Consequently, the use of the golden share to protect national interests in the UK is actually very limited.

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126 Interview with Patrick Mitchell, Tim Briggs, at Herbert Smith FreeHills, 7 June 2017.
6. Existing Foreign Direct Investment Review Systems

US - Committee on Foreign Investment in the United States (CFIUS)

The Committee for Foreign Investment in the United States (CFIUS) is the inter-agency and inter-departmental committee of the US government responsible for reviewing the implications for national security of foreign investments in US companies or projects. The self-stated remit of CFIUS is “to review transactions that could result in control of a U.S. business by a foreign person ... in order to determine the effect of such transactions on the national security of the United States”.

Established by the Ford Administration in 1975, CFIUS is comprised of representatives from 16 US government departments and agencies, including the Departments of Justice, Homeland Security, Commerce, Defense, State and Energy (among others), and agencies such as the National Security Council, the National Economic Council and the Council of Economic Advisors. CFIUS is chaired by the Secretary of the Treasury. At the time of its creation, CFIUS was primarily concerned simply with monitoring and compiling data regarding foreign investments in the US, but since the 1980s, its powers and responsibilities have grown considerably, as the US government has become increasingly aware of the potential national security risks posed by large-scale foreign investment in important US companies or activities.

The growing awareness of the national security risks posed by foreign investment resulted in the US Congress enacting the Exon–Florio Amendment in 1988, which gave the President power to block an investment if he or she felt that it posed a credible risk to national security. President Reagan then delegated the process of review and blocking power to CFIUS, a delegation of power that continues to this day. In the mid-2000s, a number of controversial proposed foreign investments led for calls to further extend and bolster CFIUS’ powers. One 2005 controversy saw DP World (a state-owned maritime conglomerate of the United Arab Emirates) attempt to acquire the port management rights of six major US ports, causing major concern among US politicians that such a move could seriously jeopardise national security. In the same year, the China National Offshore Oil Company came close to completing an $18.5 billion takeover of the Union Oil Company of California (dba Unocal), but eventually dropped the deal in the face of fierce resistance from US politicians, who argued that such a move would put essential US energy assets in the hands of a company that for all intents and purposes acted as a proxy for the Chinese government. These two incidents (among others) prompted the passing of the Foreign Investment and National Security Act of 2007 (FINSA), which makes CFIUS’ rules for review and investigation of transactions much more stringent, especially if they involve foreign governments or critical infrastructure assets. The Act also states that the Director of National Intelligence is required to act as an “ex officio” member of CFIUS, and to offer his or her input on the potential national security risks posed by transactions being reviewed by CFIUS.

**Review process of CFIUS**

The CFIUS review process begins when parties to a proposed or pending transaction file a voluntary notice with CFIUS containing details of the proposed transaction. If the Staff...
Chairperson of CFIUS (a role occupied by the Director of the Office of Investment Security, Treasury Department) is satisfied that the required information has been submitted, they will then circulate the voluntary notice to all CFIUS members, and a review process of up to 30 days formally begins.

As the various CFIUS members review the information, they may raise national security concerns as appropriate, and may request supplementary information from the transaction parties on particular issues, which must be submitted within three days of the request being made (unless an extension is granted). The vast majority of proposed transactions reviewed by the CFIUS are concluded within the initial 30-day review period, but it is possible for reviews either to be extended to 45 days or to be referred directly to the President for an executive decision, under certain circumstances. Parties to a transaction under review by CFIUS may withdraw their voluntary notice at any time during the review or investigation periods, but are made aware that CFIUS continue to track and monitor such withdrawn transactions.

In the event that CFIUS reviews a transaction and find that it presents possible national security risks, it will enter into an agreement with the transaction parties, impose specific conditions on them, or refer the case to the President for executive action.

Advantages

The inter-departmental and inter-agency composition of CFIUS allows proposed transactions to be scrutinised from numerous different perspectives, ensuring that potential national security risks are much more likely to be identified as multiple different bodies examine a transaction from different angles. The relatively speedy process of the CFIUS review (usually taking between 15 and 30 days, compared to Australia’s Foreign Investment Review Board time of 30–90 days) means that investors are less likely to become impatient, get “cold feet” or otherwise withdraw their applications.

Disadvantages

Others have argued that, perhaps unavoidably, the heightened scrutiny process – like the DP World/China National Offshore Oil Company controversy of 2005 – has discouraged potential foreign investors. Clyde V. Prestowitz Jnr., President of the Economic Strategy Institute, remarked in 2006, “We need a net inflow of capital of $3 billion a day to keep the economy afloat, yet all of the body language here is ‘go away’.”\(^{131}\) That said, there was wide consensus among economists that greater scrutiny from CFIUS would only affect a tiny minority of potential foreign investment deals, and so far this appraisal appears to be true (for example, the latest available report from CFIUS, from 2014, shows that only one out of 147 notices reviewed by CFIUS that year was actually rejected by the Committee).\(^{132}\) There have also been complaints from companies of certain countries, such as China, that they are unfairly discriminated against by the CFIUS process, and that the process is arbitrary and politicised. However, this is perhaps unavoidable; obviously, the firms of countries that are major political rivals of the US will always be subjected to particularly intense scrutiny by CFIUS.


Other critics have put forward the argument that constructing CFIUS from existing members of particular US government departments also has its downsides. They note that CFIUS members from the Treasury often have entirely different agendas and perspectives from their CFIUS colleagues from the Departments of State or Defense: economists from the Treasury claim that the national security preoccupations of their State/Defense colleagues end up discouraging essential foreign investors, while those from State and Defense argue that their Treasury colleagues are driven in a somewhat blinkered fashion by economic concerns alone, and do not take the potentially aggressive geopolitical or strategic dimensions of FDI seriously enough. Perhaps, therefore, there is a case to be made for the decisionmaker at the top of any national FDI reviewing body to not belong to any particular department or ministry, but to exist in an independent capacity.

**Australia – Foreign Investment Review Board (FIRB)**

Foreign investments made in Australia are regulated by the Foreign Acquisitions and Takeovers act (FATA) of 1975, as well as by additional legislation that has been added to FATA over the years (for example, The Foreign Acquisitions and Takeovers Regulation of 2015). One of the main purposes of FATA is to identify specific types of investment requirement that must be brought to the attention of, and to seek the approval, the Australian government. According to FATA, private foreign investors are required to seek prior government approval before acquiring a substantial interest (originally defined as 15%, but now 20% under the 2015 regulations) in an Australian corporation or entity valued at $252 million or more\(^\text{134}\) (there are certain exceptions to this – for example, for private investors from the US or New Zealand, the $252 million threshold only applies to investments in certain sensitive sectors). However, all foreign government investments in Australian corporations or entities are automatically referred to the Australian government for approval.\(^\text{135}\)

According to the Australian Parliamentary research group, separate legislation imposes other requirements and/or limits on foreign investment in the following areas:

- **The banking sector** – foreign ownership in the banking sector must be consistent with The Banking Act 1959, the Financial Sector (Shareholdings) Act 1998 and national banking policy.
- **Airports** – the Airports Act 1996 limits foreign ownership of some airports to 49%.
- **The shipping industry** – The Shipping Registration Act 1981 requires that a ship must be majority Australian-owned if it is to be registered in Australia, unless it is designated as charted by an Australian operator.
- **The telecommunications sector** – aggregate foreign ownership of Telstra is limited to 35%, and individual foreign investors are only allowed a maximum of 5%.\(^\text{136}\)

The Treasurer of Australia is ultimately responsible for all decisions relating to foreign investments, and has the authority to either apply implementation conditions to ensure that


\(^{136}\) Ibid.
Australian national interests are protected, or indeed to block an investment. Foreign investing parties have no right of administrative or judicial appeal. The Treasurer is advised on issues pertaining to foreign investment by a non-statutory, advisory body called the Foreign Investment Review Board (FIRB).

FIRB's primary role is to monitor existing foreign-controlled businesses within Australia, and to advise the Treasurer regarding incoming foreign investment. FIRB also serves an inverse function, advising the Treasurer on Australian organisations' own investments in foreign countries.

The FIRB Board comprises five part-time members and a single full-time executive member; its functions are advisory only, and responsibility for actual decision-making rests with the Treasurer.

**Advantages**

The Head of FIRB is not a member of any given government department, and thus is less likely to act in a partisan way. As noted with CFIUS in the United States, it can prove problematic if the board members reviewing foreign investments have too much of a departmental bias one way or the other - for example, reviewers from the Treasury tend to prioritise economic benefits of FDI first and foremost, while reviewers from the Department of Defense are much more cautious, predominantly concerned with national security. These biases can affect the impartiality of the review process. Because FIRB is only advisory and non-statutory, it does not have to answer to anyone in government, which again allows for greater frankness of opinion and advice.

The blanket, automatic referral of all proposed foreign government investments to the Australian government seems sensible; such a rule means that i) there is a minimised risk of potentially dangerous investments slipping through the net, and ii) it allows the Australian government to avoid allegations of unfair or discriminatory targeting of investments from particular countries.

**Disadvantages**

FIRB is very small; it has only one full-time member and five part-time members. The smallness of the organisation is disproportionate to the scale of the potential risks to national interests posed by FDI. A leaf could be taken out of CFIUS' book in this regard - at CFIUS, representatives from 16 different US government departments and agencies have an input on the FDI reviewing process, maximising the chances that the potential risks in a given proposed FDI will be identified.

**Canada – Investment Review Division**

The principle statute governing foreign investments in Canada is the Investment Canada Act (ICA), passed in 1985, the purpose of which is both to “provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities”, and also to provide for the review of investments that might pose risks to Canadian economic interests and national security. The Act permits the government to forbid foreign investments if they are not deemed to present a “net benefit to Canada”. The Minister in charge of overseeing the reviewing of the investments process is the Minister of Industry, who appoints a Director of Investments to assist in enacting the rules set out in the ICA. The Ministry of Industry will partner with the other relevant ministries on an ad hoc basis, depending on the field in which a potential investor wishes to invest.

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The Act and a review process is automatically triggered based on the size of the investment, a size which differs depending on whether or not the investing party is part of the World Trade Organization. For private investors from WTO countries, the investment threshold is $1 billion; for state-owned investors from WTO countries, the threshold for investigation is $379 million. For any non-WTO investor, the threshold is $5 million. Furthermore, investments in particular sections (such as uranium production, financial services, transportation services and cultural businesses) automatically require government review and approval. While the ICA theoretically grants the power to restrict investments from abroad, its mandate is only to “review ... significant investments ... in a manner that encourages investment” (unless there is a risk to national security), and so, accordingly, successive Canadian governments avoided using the Act to hinder foreign investment whatsoever. However, the ICA was invoked in 2008 under the leadership of Prime Minister Stephen Harper to prevent the sale of the space division of Vancouver-based technology company MacDonald, Dettwiler & Associates to a US company, Alliant Techsystems.

Under the Act, the Minister can require the investing party to provide any information the Minister deems relevant if the Minister has reasonable grounds to believe the investment may be harmful to national security. The Minister has 45 days to determine whether or not to allow an investment, and also has the right to extend the review by a further 30 days if deemed necessary. If no approval or notice of extension is received within this time period, the investment is deemed to have been approved.

In 2005, the Canadian government introduced a bill amending the FDI review process, and included provisions allowing the government to review FDI proposals based solely on national security concerns. However, the government was dissolved at the end of 2005 prior to the 2006 elections, and the bill was never passed.

Advantages

The Minister appoints a Director of Investment, which gives some political space. While the decision is under a time restraint of 45 days, but may be extended it if there are any discrepancies or issues. This gives the reviewers room to carry out further checks.

Disadvantages

A key distinction in the ICA is that between at WTO/non-WTO investor, and the financial thresholds triggering a review change significantly depending on whether one is or is not part of the WTO. This WTO/non-WTO seems of somewhat limited use, given the vast majority of the world’s countries (including those countries that Western governments are most concerned with regarding the motivations underlying their foreign investments, such as China and Russia) are members of the WTO.

EU States: An Introduction

With regard to FDI restrictions in the EU, the OECD has noted that “the most open countries are in the European Union. Since 1992, intra-EU FDI flows are almost completely unrestricted. Furthermore, a number of EU countries have minimal overt restrictions on inflows from non-EU countries.” There is no systematic centralised FDI screening on

security grounds at EU level (though EU level rules do exist on scrutinising FDI to ensure that fair competition rules are upheld), and only about half of EU member states operate national security reviews.

A briefing delivered to the European Parliament in May 2017 focussed on the issue of foreign direct investment screening in light of the unprecedented and concerning imbalance between Chinese FDI in the EU and EU FDI flowing to China that occurred in 2016 (Chinese FDI in the EU rose to a record high of $35 billion). The briefing acknowledges that Chinese FDI is driven not only by market-seeking motives, but also by strategic asset-seeking motives. Currently, the EU operates a patchwork of different mechanisms for FDI screening among its various member states, but there is ongoing debate as to whether or not these are adequate to combat the potential risks that FDI can present. Accordingly, the idea of an EU-wide, built-from-scratch FDI screening mechanism that would apply equally to all member states is being considered, based on a common legal framework. Advocates have stressed that such an EU-wide system should be as transparent and consistent as possible in order to avoid the perception of unfair bias towards certain investing parties or nations. In February 2017, the French, German and Italian Ministers of the Economy wrote to the EU Commissioner for Trade to highlight the pressing nature of the inadequacies in the current system.

**France – The Economy Ministry**

Regarding French restrictions on FDI, “no laws or practices discriminate against foreign investors by prohibiting, limiting or conditioning foreign investment except in a few specified sectors”. The formal French investment regime is said to be among the least restrictive in the world. However, despite this, the criteria for triggering an investigation into a proposed FDI in France are generally somewhat “subjective”.

French law (decree 2005-1739) states that foreign acquisitions in certain sectors are subject to prior notification/screening/approval by the Economy Minister; the 11 specified sectors between 2005 and 2014 were:

- gambling; private security services; research, development and production of certain pathogens or toxic substances; wiretapping and communications interception equipment; testing and certification of security for IT products and systems; goods and services related to the information security systems of companies managing critical infrastructure; dual-use (civil and military) items and technologies; encryption services; the activities of firms entrusted with national defense secrets; research, production or trade of weapons, ammunition, and explosive substances intended for military purposes; and any business supplying the Defense Ministry with any of the above goods or services.

In 2014, six new areas were added to this list: energy infrastructure; transportation networks; public water supplies; electronic communication networks; public health protection; and installations/works vital to national security. Any investment in these sectors that surpasses a 33% ownership threshold, or involves any part of such a firm that has established headquarters

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in France, must be reviewed by the Economy Minister, who will make a decision based on a formal application within two months of receiving it.146

In the event that the Minister fails to respond to the prospective investor within the allotted review period, it is assumed (by law) that the investment proposal has been accepted. During the review process, representatives from other departments relating to the sector in which the investor is proposing to invest will aid the Economy Minister in his or her decision-making. The Economy Minister then has the power to impose changes or conditions on the proposed investment, or block it outright, though under French law the investing party has the right to appeal in court in both these situations.

Newly elected President Emmanuel Macron has indicated that he would like to see a tightening of rules and regulations regarding investments from foreign entities in “strategic sectors” across the EU, but has so far failed to make significant progress in this regard.147

Disadvantages

The assumption that an investment has been authorised if the Economy Minister fails to make a decision within the required time could prove problematic, for obvious reasons, especially in a country with a heavy culture of laden state bureaucracy (in which, ergo, the government tends to move relatively slowly).

The lack of clear established criteria for what sort of investment will trigger an investigation is presumably off-putting to potential foreign investors. The arbitrary nature seems overly political.

Germany – The Federal Ministry for Economic Affairs and Energy

The German government and industry actively encourage foreign investment and as the OSCE Regulatory Index revealed, it has one of the least restrictive markets. In principle, Germany’s Foreign Economic Law contains a provision permitting restrictions on private direct investment flows into or out of the country for reasons of foreign policy or national security, though in practice these restrictions have only been imposed in the sectors of air transport, maritime transport, inland waterways and rail transport.148

Until 2004, Germany had no specific legislation that impacted FDI beyond general restrictions.

According to Friedoline Strack at BHI,

“Until mid-2017 the German government had to decide within 30 days on a possible acquisition by a foreign investor. This period has been much too short for a proper analysis on possible negative effects on German national security and public order. The law has been amended on 12 July 2017 to extend the period of examination of a possible acquisition to 3 months. The network necessary for the screening process on foreign investment including the Ministry of Economic Affairs and Energy, the Defense Ministry, the Foreign Office with its Embassies abroad, other governmental bodies and experts from business definitely needs to be improved.”149

149 Interview, 6 July 2017.
Today, the German FDI screening mechanism has two pillars: sector-specific scrutiny applicable to all acquisitions of firms manufacturing or developing war weapons or armaments or producing cryptographic equipment, and cross-sector scrutiny that may be triggered by the acquisition of more than 25% of voting rights in the company to be acquired, although the latter is only applied to investments from non-EU and non-European Free Trade Association (EFTA) countries. In the event that a review is triggered, The Federal Ministry for Economic Affairs and Energy (the relevant reviewing body) then has one month in which to raise potential objections, and if none are raised within that time (much as under the French system), the transaction is regarded as approved.

In Germany, there is no compulsory registration for non-EU takeovers or investment unless there is a direct military link, which then requires a sector-specific review. In other cases, Germany’s Ministry of Economic Affairs can initiate a cross-sector review on an acquisition by a non-EU investor only if it considers it to be a potential threat to public security. The German ministry undertook 338 such reviews on foreign acquisitions of domestic companies between 2008 and November 2016; all except one of these reviews was requested by the investor in order to pre-empt potential concerns.

Review process

Reviews of proposed FDI are conducted by the Federal Ministry of Economics and Technology, with inputs from the Ministry of Defense and the Ministry of Foreign Affairs (among others) where national security is deemed to be a factor at play. According to German officials, approval or refusal of an investment is generally a matter of consensus between the various ministries involved. The German government has one month to reach a conclusion on the review, after which time a proposed investment will be considered to be automatically valid. German law allows for the investing party to appeal the verdict of the German government regarding a review, but as there have been no denials, there have not been appeals.

Japan – The Ministry of Finance and other bodies

The position of the Japanese government is explicitly to promote FDI, historically a relatively small part of Japan’s GDP. Accordingly, it has noted that “generally speaking, foreigners can conduct business in Japan on an equal legal footing with Japanese citizens”. Legislation dating back to 1949 (though it has been updated multiple times), called FEFTA (The Foreign Exchange and Trade Act), is the primary legal bill dealing with FDI in Japan. FEFTA gives the government the power to prohibit or place conditions on a proposed foreign investment if it determines that it may harm national security.

Nevertheless, there are criteria under which a foreign investor is required to gain the prior approval of the Japanese authorities. Firstly, 30 specific countries are required to gain prior approval of the Japanese government before they are permitted to invest in Japan (including Iraq and North Korea). Secondly, foreign investors seeking to invest in any of the following industries are also required to seek prior approval: industries related to national security, public policy or public safety, such as weapons, aircraft, satellites, nuclear energy, electric power, gas,

the supply of heat, telecommunications, broadcasting, water supply, railway service, transportation, medical products and security services, plus certain other industries which the Japanese government reserves the authority to restrict (such as agriculture, forestry, fishery, oil, leatherwear, air transport and marine transport). In other instances, there are firm non-negotiable rules that place explicit restrictions on foreign ownership: Japanese airline companies and transportation companies are limited to one-third foreign ownership, broadcasting companies one-fifth, while mining businesses in Japan can only be owned by Japanese citizens and companies.

For foreign investments that are not in sectors requiring the prior approval of the Japanese government, there is nevertheless a requirement to register all foreign investments in Japan with the Ministry of Finance within a limited time period after the transaction has occurred. Failure to do so can result in significant financial penalties.

**Review process**

If a foreign investing party fulfils any of the criteria requiring it to gain prior approval from the Japanese government, it must submit information to both the Japanese Ministry of Finance and the appropriate ministry with industry area jurisdiction. This information must include the percentage of shares they plan to acquire, the business plan of the investing company and the reason for the transaction. While threats to national security, public safety or the economy are all factors considered in the reviewing process, precise details of the criteria for assessment are not published. Ministries then have 30 days to review the application. If the investor has not received a response by the end of this period, the investment is assumed to be permitted; however, the ministries can choose to prolong investigations by up to four months if they so wish. The Japanese judicial system does allow for a public hearing in the event that an investor wants to contest the verdict of the ministerial review.

**Taiwan – The Investment Commission**

In order to encourage FDI during a time of slowing national exports and general economic underperformance, the Taiwanese government has adopted an open policy with respect to foreign investors, with few prohibitions based on considerations of national security. Nevertheless, in some specific industries, foreign investments are prohibited (the postal system, broadcasting and television, to name three), while in others, foreign investments are restricted (meaning that prior permission is required from the relevant governmental authority), such as in the energy and insurance sectors. The regulatory body for foreign investment in Taiwan is the Investment Commission, part of the Ministry of Economic Affairs (MOEAIC). Once an investing party has applied to be reviewed by the Investment Commission, the length of time the review takes depends on the amount of capital involved. Investments of 500,000,000 TWD or less (approximately £12.7 million) are usually reviewed within two to four working days, between 500,000,000 and 1,000,000,000 TWD in three to five working days, while investments of more than 1,000,000,000 TWD can take between 14 and 30 days.

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7. Conclusion

This report set out to answer the question of whether or not the current UK system for reviewing Chinese investment is working sufficiently, or whether it requires adjustment for the new investment surge of Chinese state-owned enterprises into the UK’s high-tech, infrastructure and manufacturing sectors. While this report is only meant to serve as a preliminary finding into what will be a longer research track, it is clear from the three case studies that the current system is not sufficiently protecting the UK. It is clear that the investment environment is changing rapidly, both in volume and – some have alleged – in strategic scope. While Made in China: 2025 may provide short-term opportunities for UK business, there are elements to the strategy that threaten the long-term innovative lead of the UK’s high-tech and communications sectors. Looking at the case study of solar panels, one can see that China’s massive SOE eco-system, fuelled by strong state banking subsidies, means that China’s companies are not competing on a level playing field. There is every possibility that they might snap up the best, cutting-edge British IT and telecoms companies in order to gain valuable intellectual property.

As the Hinkley Point C controversy revealed, there are also very serious concerns regarding investments by China and other foreign state-owned entities into the UK’s critical national infrastructure. The dangers are twofold: there are in the first instance concerns about control over those elements of the infrastructure that might be utilised in the service of another state’s foreign policy objectives. As hopefully has been demonstrated, there are scenarios – perhaps involving Taiwan or the South China Sea – in which China's commercial interests would be secondary to its national interests. The second danger is, of course, that its financial leverage would be used to gain political influence over a state’s choices. The example of Greece is perhaps most relevant, and while different in scope from an economy like the UK, the danger of overt Chinese influence on the UK’s foreign policy choices should not be simply discounted. It should be monitored and borne in mind when allowing in new investments.

UK politicians are now debating whether the scope of the government’s ability to intervene should be extended or not, and if yes in what way. There are currently two possible options to reform UK foreign investment law:

1. Reform and strengthen the Enterprise Act by expanding and or clarifying the scope of the “national security” definition in relation to the defence sector, and expand the use of golden shares (for nuclear projects or infrastructure).

2. Introduce a new regime and create a dedicated body with responsibility for controlling foreign investments alongside the government scrutiny, inspired by the US Committee on Foreign Investment in the United States (CFIUS), or the Australian Canberra Foreign Investment Review Board (FIRB).

If the UK government is to create a new regime, what might that look like? There are a number of different ways that the UK might review foreign direct investment into its economy:

**Cabinet Office:** A Cabinet Office could take the lead on reviewing sensitive investments.

**Strengths:** Its advisory role over the various departments of government might make it a natural lead in approaching the complex issue of investment and infrastructure security.

**Weaknesses:** One weakness would be capacity, since the CO already has a range of issues to look at, and any regime must be sufficiently robust and resourced. Furthermore,
since the Cabinet Office is advisory, the power of any rulings or decisions it makes over cases must be clarified.

**Departmental:** Another possibility is for one department to take ownership of the issue. Possibilities might include the Treasury, the Department of Trade, the Department of Business, Energy and Industry, or the Home Office.

**Strengths:** This would locate the body within one department, making it easy to locate, easy to support and easier to budget.

**Weaknesses:** If contained within one organisation, it may find that its purview is overly influenced by its departmental ethos. A trade-hosted review body may be overly eager for investment, while a security-hosted review body may be overly critical of investment.

**Cross-departmental:** A third possibility is for a cross-departmental “whole-of-government” approach. In such an instance, one ministry would host the physical office, but its budget, personnel and policy direction would be divided up between two or three other departments.

**Strengths:** This would seek a balanced approach between pro-investment and prosecurity departments, using a common funding pool, shared personnel and civilian pool of experts.

**Weaknesses:** It might become a point of contention between the various departments, perhaps without any one strong defender at the Cabinet level.

The primary strength of any of these three choices would be to put the locus of UK investment screening with one institution. This would make it easier for the UK to coordinate more closely with NATO and Five-Eyes allies over trends in Chinese investment, sector targeting and other areas of concern.

While it seems unfair to focus so much attention on China, this report has done so because it is rapidly becoming the world’s largest contributor of OFDI and because it is rapidly becoming the UK’s largest source of FDI from Asia. Furthermore, the nature of its statecapitalist model and the increasingly party-led nature of its economy and political system are at odds with the UK’s open values and pluralistic system. There are opportunities for it to take advantage of that by pressing the UK in a more a more coordinated way than most liberal democracies. Furthermore, Beijing’s economic strategy Made in China: 2025 seems to aim for a large part of the supply chain of key future dual-use technologies could threaten the UK’s own economy and IT sector. Now, more than ever, the UK must develop a robust and swift mechanism for screening investment into its digital and critical national infrastructure. We hope that the Government of the day will consider the positions laid out in this paper and take action before too much of the UK’s digital and critical national infrastructure is in the hands of companies aligned with a foreign power. As we hope to have made clear, Chinese investment – and any nation’s investment – is welcome in the UK, but in a reasoned, considered, and careful manner, in which the UK’s security is balanced with its economic interests.
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The Asia Studies Centre attempts to provide an in-depth understanding of the structural shifts, regional complexities and historic tensions that exist alongside the tremendous economic and social growth that traditionally characterise the “rise of Asia”. With some predicting that the region will account for 40% of global GDP by 2050, a post-Brexit Britain must develop a foreign policy posture for the region that navigates British economic interests and cultural and political values on the one hand, while maintaining strong support for regional liberal democracies and international law on the other.