Rome-Beijing: Changing the Game

Italy’s Embrace of China’s Connectivity Project, Implications for the EU and the US

by Nicola Casarini

ABSTRACT

Italy wants to be the first G7 nation to sign a Memorandum of Understanding on the Belt and Road Initiative, China’s massive infrastructure and connectivity project. Through the Memorandum, Italy seeks more market access in China for Italian companies and “Made in Italy” products, as well as more Chinese investments in Italy under the Initiative framework. Besides commercial considerations, there are important geo-strategic implications to consider. Italy’s endorsement of Chinese President Xi Jinping’s signature foreign policy initiative undermines European Union efforts at finding a common stance vis-à-vis Beijing. It also weakens the position of the United States in its tug-of-war with China over trade and global leadership. Remarkably, it is Italian populists in power in Rome – though there are differences between the two coalition partners – who are willing to defy their mentor in the White House by helping China drive a wedge in the Euro-Atlantic alliance.
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by Nicola Casarini*

Introduction

The announcement by Giuseppe Conte, Italy’s Prime Minister, that Italy could sign a Memorandum of Understanding (MoU) on the Belt and Road Initiative (BRI) – China’s massive infrastructure and connectivity project – during the state visit by Chinese President Xi Jinping to Rome on 22 March 2019 has caused alarm in Washington and uneasiness in Brussels, Berlin and Paris, as it occurs on the same day as an important European Council (scheduled for 21–22 March) that seeks to fashion a common approach towards China.¹

Italy’s interest in establishing closer ties with Beijing is not new. Paolo Gentiloni, Italy’s former Prime Minister, attended the first Belt and Road Forum in Beijing in May 2017 – the only leader of a G7 country to do so.

An MoU of this sort is usually a 3- or 4-page document. The language is intentionally vague, simply stating support for the Chinese initiative. The document is non-binding and outlines a framework for cooperation between China and the concerned country in various areas, including trade and infrastructure projects (numerous countries and international organisations have already endorsed similar documents with China). The MoU that Italy is considering signing also contains clear language consistent with Western norms and principles.²

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2 For the draft text of the China-Italy Memorandum of Understanding, see “Via della Seta, il testo dell’intesa tra l’Italia e la Cina: la versione inglese e la traduzione in italiano”, in Corriere della Sera, 12 March 2019, https://www.corriere.it/economia/19_marzo_12/via-seta-testo-dell-intesa-l-italia-

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Large Chinese investments and loans tend to be attached to a MoU, which explains why so many governments have been willing to sign. For Italy, it could mean more market access in China for Italian companies and “Made in Italy” products, as well as more Chinese investments in Italy under the BRI framework. Beijing now accounts for about 2.7 per cent of Italy’s exports, valued at just over 11 billion euro. This makes China the eighth largest export market for Rome. Imports from Beijing are worth more than 27 billion euro, which corresponds to 1.3 per cent of the Chinese export market. In terms of rankings, Italy is China’s 19th largest export market. In the last two decades, Chinese companies and financial institutions have invested in more than 600 Italian enterprises, for a total value of 13.7 billion euro, according to the Italy-China Foundation.3

Italy is a G7 country and a founding nation of the EU. Signing a MoU with China has not only commercial consequences – as some members of the Italian government would like the public to believe – but also important geo-strategic implications. President Xi will use Italy’s embrace of his signature foreign policy initiative to reduce the chances of Western powers “ganging up” against China, hoping instead that other important EU members will eventually follow Italy’s lead in signing on to the BRI. Italy would indeed be the largest economy so far to endorse China’s infrastructure project and could well play the role taken by the United Kingdom in 2015, when London was the first to join the Chinese-led Asian Infrastructure Investment Bank (AIIB) despite opposition from the Obama administration. Other European countries followed suit, undermining any prospect for a common EU position.

It would be naïve to ignore the perspective that Italy’s embrace of the Belt and Road Initiative – Beijing’s geopolitical alternative to Washington’s pivot to Asia – weakens the position of the United States in its tug-of-war with China over trade and global leadership.4 Remarkably, the Italian government is one of the most supportive of US President Donald Trump among European executives, and yet on China – Trump’s obsession – Italian populists seem willing to defy their mentor.

This paper explains why the Italian government is willing to break ranks with its traditional Western allies. It is based on open source documents and interviews with Chinese, American and European policymakers.

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1. The Belt and Road and its critics

The Belt and Road Initiative was unveiled by President Xi Jinping in late 2013. It is China’s most ambitious geo-economic and foreign policy initiative in decades, combining a land-based Silk Road Economic Belt and a sea-based 21st Century Maritime Silk Road, which together connect China to Europe through Southeast Asia, Central Asia, the Middle East and Eastern Africa. The stated aim of this grandiose project is to boost connectivity and commerce between China and more than seventy countries traversed by the Belt and Road.\(^5\)

China’s total financial commitment to this initiative is expected to surpass 1 trillion dollars in the coming years. Beijing has already committed around 300 billion dollars for infrastructural loans and trade financing, a sum which includes a 40 billion dollar contribution to the Silk Road Fund for infrastructural development and the 100 billion dollar initial capital allocated to the China-initiated AIIB.\(^6\)

The BRI is not limited to physical infrastructure and commerce. President Xi Jinping has talked about “five factors of connectivity” which define the new Silk Roads, namely (i) policy communication, (ii) road connectivity, (iii) unimpeded trade, (iv) monetary circulation and (v) understanding between peoples, including intellectual exchanges and flows of tourists and students.\(^7\)

The projects related to the BRI are expected to be realised over the next three decades, culminating in 2049 – a symbolic date marking the 100th anniversary of the foundation of the People’s Republic of China. The Chinese Ministry of Commerce has coined the term “the new 30 years” (xin 30 nian), a reference that puts today’s China on the threshold of a third era comparable to those begun by Mao Zedong and Deng Xiaoping.\(^8\) The catchphrase of this new era under the leadership of Xi Jinping is the “China Dream”, devised to guide the country’s development in the coming decades.\(^9\)

The Belt and Road is an essential part of Xi’s China Dream vision. The initiative is presented to potential partners as an open and unconditional plan, with

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\(^9\) Nicola Casarini, “When All Roads Lead to Beijing”, cit., p. 98.
emphasis given to economic considerations and infrastructures. Unlike the US, which opposed it from the start, the Europeans have shown interest in the BRI. All EU member states have joined the China-led Asia Infrastructure Investment Bank, which is designed to lend financial support to BRI-related initiatives. Several projects supported by the AIIB are co-financed by the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD). However, in recent times the BRI has attracted criticism from many European capitals.

**Western criticism**

In April 2018, the German business newspaper *Handelsblatt* revealed that 27 of 28 ambassadors from the EU in Beijing compiled a report accusing the BRI of limiting free trade and providing subsidised Chinese companies with unfair advantages. The Hungarian ambassador in Beijing was the only one to refuse to sign the document.\(^\text{10}\)

There are growing concerns in Europe that through the Belt and Road Initiative, China seeks to tackle industrial overcapacity at home by dumping goods priced below production cost, a strategy that could bring some industrial lines across Europe to their knees. Moreover, EU policymakers fear that Beijing wants to revise the global rules on commerce and investment, worrying that the Chinese initiative lacks transparency and that the opaque financing deals may threaten the competitiveness of European companies. It is increasingly evident that Chinese companies are awarded contracts with little respect for open procurement rules. This raises the question of reciprocity. While Chinese companies find an open-door environment in Europe, it is quite difficult – if not impossible – for a European company to succeed in winning a contract to build infrastructure projects in China.

Western criticism of the BRI has increased in the last months, following developments in some of the first beneficiary countries of BRI investments. Pakistan, for instance, now wants to renegotiate agreements related to the China-Pakistan Economic Corridor (CPEC), signed under China’s BRI, for fear that it could become a “debt trap” for the country. Malaysia has cancelled a pipeline project linked to China’s BRI and suspended other BRI projects estimated to be worth nearly 20 billion dollars.¹¹

Western policymakers worry that China is encouraging indebtedness in various countries in order to gain control of strategic assets when debtors default on repayments, although Beijing denies this.¹² Western media recently reported that Sri Lanka was forced to surrender a 99-year lease on a strategic port to a Chinese conglomerate after the port (financed with loans from Beijing) failed to generate significant income.

Both the US and the EU have acted to respond to China’s BRI. Washington has created an agency, the US International Development Finance Corporation, which could invest up to 60 billion dollars to counter China’s use of debt-trap projects to gain influence abroad.¹³ The EU has adopted its own connectivity strategy for the Euro-Asian region and an investment screening mechanism clearly aimed at Beijing.

2. Europe’s connectivity concept

The 2016 Global Strategy committed the EU to strengthening relations with a “connected Asia” and called for a “coherent approach” to connectivity. In this vein, on 19 September 2018 Federica Mogherini, High Representative for Foreign Affairs and Security Policy, and Cecilia Malmström, the European Commissioner for Trade, unveiled the EU’s connectivity strategy. The initiative touches on all modes of transport links – land, sea and air – as well as digital and energy links in the Eurasian area. It seeks to promote a shared concept of connectivity that respects labour, social and environmental standards and follows the principles of sustainability, transparency, free market, open procurement, and equal treatment and equal access – principles that Chinese companies investing in the framework of the BRI rarely uphold.

The EU’s connectivity strategy is linked to a new piece of legislation aimed at limiting China’s penetration into key industrial and strategic sectors in the bloc: the screening mechanism.

The European Commission first proposed to establish a framework for member states, and in certain cases the Commission itself, to screen foreign direct investments in the EU in September 2017. After 18 months of negotiations, the European Council of 21–22 March is expected to give the green light to the screening mechanism, which would enter into force in April. It is worth noting that during the vote on the draft text in the EU Council on 5 March 2019, 26 out of 28 EU members approved the screening mechanism, including countries such as Hungary and Greece traditionally considered close to Beijing’s interests. The two outliers were the United Kingdom, which is halfway out of the bloc, and Italy. In so doing, the populist coalition in Rome reversed the position of the previous centre-left Gentiloni government, which had joined Germany and France in sending a letter to the European Commission in February 2017 to back calls for an EU-wide investment screening mechanism.

The screening mechanism will help the European Commission and the EU member states to evaluate whether a foreign investor is in reality controlled by a third country government. This is clearly aimed at Chinese state-owned enterprises.

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The screening mechanism makes it more difficult for them to acquire expertise and technology that could be used to produce goods sold at lower prices.

The adoption of an EU-wide screening mechanism is also the result of intensified transatlantic cooperation on China. One of the consequences of the ongoing US--China trade war has been the toughening of the US investment regime toward Chinese companies. This has led Beijing to concentrate its attention on the European market, following a slump of Chinese investments in the EU over the last two years.

According to a report by the Rhodium Group and the Mercator Institute for China Studies, Chinese foreign direct investment in the EU fell 40 per cent to 17.3 euro billion in 2018. The report explains this decline by a tightening in China’s capital outflows, but also by growing regulatory scrutiny in host European economies. Notwithstanding, Europe has emerged over the years as the top destination for China’s outbound investments. Between 2000 and 2014, Chinese companies spent 46 billion euro on 1,047 direct investments (green-field projects and acquisitions) in the EU 28 countries, with the vast majority of the transactions coming after 2009.

3. Chinese investments in Italy

Germany, France and the United Kingdom have long been the preferred destinations for Chinese investment, but since 2014 interest in Italy has soared. In 2015, ChemChina’s acquisition of Pirelli put Italy in the top position for the year.

The Pirelli deal has been complemented by other green-field investments – but portfolio investments have also surged. The investment arm of the People’s Bank of China, the State Administration of Foreign Exchange, has invested almost 3.5 billion euro in shares, representing about 2 per cent each in ten of Italy’s largest companies in the banking (Monte dei Paschi di Siena, Unicredit, Intesa SanPaolo, Mediobanca), energy (Saipem, Enel, Eni), automaker (Fiat Chrysler Automobiles), telecommunication (Telecom Italia), cables and systems (Prysmian) and insurance (Assicurazioni Generali) industries.

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By mid-2017, according to estimates by *Il Sole 24 Ore* (Italy’s main financial newspaper) – based on data from the S&P Global Market Intelligence database – Beijing had invested more than 5 billion euro in listed companies on the Italian stock market, a sum that corresponded to around 10 per cent of total Chinese investments in European stocks (almost 60 billion) at that time.21

According to the 2018 report of the Italy-China Foundation (*Fondazione Italia-Cina*), more than 600 Italian companies have received some Chinese investment for a total value of 13.7 billion euro since 2000.22 Acquisitions have been facilitated by the small size of most Italian companies, although Chinese investors have also targeted big companies. The main reasons for investing in Italy are:

1. Moving up the value chain by acquiring technology, know-how and brands in sectors where Italy has achieved global competitiveness.
2. Building economies of scale, as in the case of ChemChina’s acquisition of Pirelli.
3. Sending a political message to Rome, as in the case of China’s decision to invest just above 2 per cent in companies listed on the Milan stock exchange, a move that requires public disclosure.

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4. Acquiring logistical bases and direct access to Europe’s internal market for Chinese products, as in the case of Huawei, whose European headquarters are in Milan.

5. Implementing the Belt and Road Initiative, as Chinese investors are aware that outward investment in the BRI framework tends to receive smoother approvals from Chinese authorities.

In the last couple of years, there has been a decline of Chinese investments in Italy, in line with the more general fall of Chinese company deals in the old continent. By playing hardball on the screening mechanism in Brussels and by announcing the intention to sign a Memorandum of Understanding on the BRI, the populist government in Rome is betting on an increased flow of Chinese investments into Italy.

4. Italy’s place in the Belt and Road Initiative

The visit of Paolo Gentiloni, Italy’s Prime Minister, to China in May 2017 to attend the first Belt and Road Forum – the only member of a G7 country to do so – highlighted Italy’s interest in becoming part of China’s massive infrastructure project.

That interest is very much reciprocated. Sitting at the centre of the Mediterranean Sea, which is the end-point of China’s 21st Century Maritime Silk Road, Italy is seen in Beijing as an important partner for the success of Xi’s flagship initiative. Investments made in the Belt and Road framework tend to receive acquisition funds more easily. For instance, when ChemChina bought Italian tire maker Pirelli for 7 billion euro in 2015, the deal was funded in part by the Silk Road Fund, which took a 25 per cent stake in the ChemChina unit set up to buy Pirelli’s shares.

Italian ports and rail connections to the markets in Central, Eastern and Northern Europe have become a focus of attention for the Chinese government. Until a few years ago, Italy’s flagship project presented to the Chinese side was the five-port initiative involving the Italian ports of Venice, Trieste and Ravenna plus Capodistria (Slovenia) and Fiume (Croatia), linked together in the North Adriatic Port Association. Launched in 2014, the five-port alliance has encountered some problems, mainly due to domestic political dynamics. The Italian side of the project has, however, been resurrected in the last years, also due to growing pressure from both Italian businesses and Chinese authorities keen on promoting the BRI.23

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The Italian government is now focusing on the ports of Trieste and Genoa, since they have the capability to attract, and service, China’s huge cargo ships reaching the Mediterranean Sea via the Suez Canal. The port of Ravenna has also begun to attract Chinese interest. In June 2018, China Merchants Industry Technology made a substantial investment there. A number of Chinese companies have already shown interest in Italian ports. These include the port authorities of Shanghai and Ningbo; the CCCG Group (the world’s sixth largest infrastructure company); and the Industrial and Commercial Bank of China. The latter has opened branches in Italy and has designed loan schemes to finance Belt and Road projects open to both Chinese and Italian firms.

China’s Belt and Road Initiative undoubtedly creates opportunities for Italian companies. In the last years, however, fears have emerged that through investments Beijing may have access to sensitive technology and critical infrastructures, as well as gaining some unwanted political influence. To respond to these concerns, in October 2017 the Italian government strengthened the existing national screening mechanism to ward off predatory investments made by third countries in key strategic sectors.

The regulation entered into force on 13 October 2017, reforming the current rule of the so-called “golden power” – special powers the government can exercise in order to guarantee the country’s national security. To determine whether an inbound investment could have an impact on internal security and public order, the government can now take into consideration the eventuality that the foreign investor is in reality controlled by a third country government. This is clearly aimed at Chinese state-owned enterprises. Use of the “golden power” makes it more difficult for them to acquire expertise and technology that could be used to produce goods sold at lower prices.

The question of the “golden power” has been raised in recent weeks in relation to Huawei. In early March 2019 Luigi Di Maio, head of the senior party in the coalition, the Five Star Movement (M5S), Vice-Premier and Minister for Economic Development, was asked by the League (the junior party) to exercise the golden power to rein in Huawei’s influence on the Wifi.italia.it project, which is implemented by Infratel, a company controlled by the Ministry of Economic Development (MISE). According to the MISE, Infratel has subcontracted to Huawei all related infrastructure for the Wifi.italia.it project. Di Maio has not yet invoked the golden power for Huawei, but the MISE has created a special commission to monitor Huawei’s investments in Italy and their potential implications for national security.

The initiative by the League, however, was intended to send a reassuring message to the Trump administration, which is concerned about Huawei and asked NATO allies to ban the Chinese company from 5G internet networks. The League’s initiative highlighted division within the populist government on how to deal with China. Matteo Salvini, Vice-Premier and the League’s leader, has several times voiced his reservations towards the signing of the MoU.
5. The populists and China

The populist government in Rome wants more market access in China and more Chinese investments in Italy. To this end, some sectors of the government are willing to defy EU unity and US concerns in order to send a friendly message to China. Defying EU unity is not a big problem for the current Italian government which has largely embraced a Eurosceptic narrative.\(^{24}\) The Italian government has consequently become increasingly marginalised in Europe, having neglected, and on some occasions even antagonised, traditional allies like France and Germany. At the same time, the populist government has sought to establish closer links with the Trump administration.

Following a Trumpian script, the Italian government is enforcing policies that put national interest above EU rules. It is an “Italy First” approach, which means support to only those initiatives that benefit Italian companies and producers. In this context, playing hardball on the investment screening mechanism and breaking ranks with the rest of EU member states to extract concessions from China is deemed to be in line with the (perceived) national interest.

Italian populists have not always been pro-China. On the contrary: during the electoral campaign for parliamentary elections last year, both M5S and the League used anti-China rhetoric to woo blue-collar workers and the impoverished middle class, using themes reminiscent of Trump’s presidential campaign in 2016. Yet, things have been changing since summer 2018, as Italy’s populist government has looked for additional resources to follow through on costly electoral pledges, namely the flat tax for the League and the universal basic income for the M5S. It was in this context that Economy Minister Giovanni Tria made his first trip abroad to China in August 2018, exploring whether Beijing would be willing to help Italy economically, including through the prospect of China buying Italian bonds after the European Central Bank’s quantitative easing comes to an end.

Italy’s Economy Minister has several times praised China and its connectivity strategy. In December 2018, Tria declared that the Belt and Road was creating a “circle of virtuous, satisfying and diffuse growth” and that it “is a train that Italy cannot afford to miss”.\(^{25}\) Michele Geraci, Undersecretary of State in the Ministry of Economic Development with responsibility for international trade and investments, wants Rome to set up a comprehensive partnership with Beijing so that Italy can become China’s main economic and political partner in Europe. Geraci lived in Shanghai for years until he was appointed to his current post. He is the main architect behind the China Task Force set up in October 2019 under the Ministry of Economic Development.


Vice-Premier Di Maio is also pro-China. He first suggested the signing of a bilateral MoU during a visit to China in September 2018. On that occasion, the two sides signed an MoU for investments in third-party countries. Some expected Di Maio to use his next visit to China – which coincided with the opening of the China International Import Expo in Shanghai in November 2018 – as an opportunity to sign the MoU. That did not happen due to a lack of agreement within the government and US pressure. This setback did not prevent Di Maio from signing important contracts with the Chinese counterpart, including a deal for fifteen helicopters produced by Leonardo, a 60 million euro contract with Ansaldo Energia for a gas turbine for the Minhang power plant in China, and an agreement with Fincantieri to create a cruise hub in the Baoshan district in Shanghai. An important agreement for the export of Italian citrus fruits – which can now be shipped to China by air as well as by sea – was also finalised.

The pro-China members of the Italian government point to the benefits of closer ties with Beijing. In the case of the M5S, this position is also ideological. Since 2013, when the M5S became a significant force in the Italian Parliament, its leaders have repeatedly declared their desire to lessen Italy’s dependence on the US and NATO, boosting instead relations with emerging countries, in particular the BRICS (Brazil, Russia, India, China and South Africa).

The League, on the other hand, has traditionally held a critical position towards China. Salvini is intent on consolidating ties with Trump and wants to be seen as a pro-US and pro-NATO figure. Other important members of the League, such as Giancarlo Giorgetti, the powerful Undersecretary of State under PM Conte, and Guglielmo Picchi, Undersecretary of Foreign Affairs and Salvini’s advisor on foreign policy, have voiced reservations about the signing of the MoU. Likewise, government officials in key ministries (Foreign Affairs, Defence), as well as the security apparatus and intelligence services, are concerned about the implications that closer ties with Beijing would have for NATO and the transatlantic alliance. The pro-China members of the government have timing on their side. Xi’s visit to Italy in March 2019 comes at a moment of weakness for the Italian economy, and they hope that Beijing could help reverse this trend.

**Italian weakness, Chinese strength**

According to the Parliamentary Budget Office – a non-partisan body – the Italian economy slowed in 2018. In the fourth quarter of that year, economic activity, which had already contracted in the summer, fell by 0.2 per cent, confirming Italy’s third recession since the global financial crisis a decade ago. The country’s business sentiment is at its weakest point in six years and employment growth at the slowest in four years.26

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Italy’s coalition government is pushing forward heavy spending plans – including a universal basic income, a key electoral pledge of the M5S. This heavy spending has sparked a spat with the EU and pushed up bond yields, making it more costly for Italy to refinance its huge public debt.

The Bank of Italy has calculated that the country must sell 226 billion euro of medium-and-long-dated debt in 2019, in a situation characterised by uneasiness among investors about the possible impact of weaker growth on Italy’s high debt/GDP ratio. Italy risks further downgrading of its credit status by the rating agencies which this time may strip the country of its investment-grade rating.

It is in these circumstances that the Chinese President arrives in Italy at the end of March 2019. Beijing has amassed the world’s largest foreign exchange reserves, which reached 3.073 trillion dollars in January 2019. A commitment by the Chinese government to continue to buy Italian bonds when they reach maturity (roll-over) would certainly help – and Italy’s Economy Minister Tria is working in this direction. China is currently attracted by the high bond yields that Italy is forced to pay to investors. Moreover, the sums to be mobilised are a tiny fraction of Beijing’s foreign reserves – and the signing of an MoU is priceless for the Chinese leadership.

Conclusion

By signing the MoU with China – a move that would undoubtedly send a friendly political message to Beijing – the Italian government hopes to obtain three things: more market access in China for Italian companies and “Made in Italy” products; more Chinese investments in Italy under the BRI framework; and a commitment by China to buy Italian bonds even in a situation of turbulence in international markets. However, by officially endorsing the BRI the Italian government helps China drive a wedge into the Euro-Atlantic alliance; undermines EU efforts at finding a common stance vis-à-vis Beijing; and weakens Trump’s position in his tug-of-war with Xi Jinping over trade and global leadership. But this seems to be the price to pay for an “Italy First” approach that puts the national interest above all else. History will tell whether this is the right approach, in the 21st century, for a country like Italy.

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