CHAPTER 5

The EU as a Geoeconomic Actor? A Review of Recent European Trade and Investment Policies

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Introduction

Geoeconomics has become a key term in scholarly assessments of global economic politics. While it remains contested, the term commonly stands for the presumed tendency in international relations to use economic policy instruments to pursue foreign policy goals related to security or

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geopolitics (cf. Blackwill & Harris, 2016, p. 9). A central idea is that the increase of economic interdependence does not necessarily facilitate cooperation, as liberal internationalists purport (Keohane, 1984; Keohane & Nye, 2017), but also leads to security externalities that make countries more vulnerable to potentially hostile or otherwise harmful behaviour of other countries (Aggarwal & Reddie, 2021, p. 139). Considering emerging economic and political powers—notably China—governments increasingly use economic policy to defend their national security and other non-economic interests (Roberts et al., 2019). Some scholars see a shift away from multilateralism, as global economic politics are increasingly perceived as a "zero-sum" rather than a "positive sum" game (ibid.). While nuances differ, these scholars share a realist understanding of world politics: countries seek to increase their own power position at the expense of strategic competitors. Gertz and Miles explicitly define geoeconomics as "the economic dimension of great power competition" (2020, p. 119).

Much of this recent literature on the proclaimed geoeconomic turn in global politics has, however, been developed with the US–China rivalry in mind (Roberts et al., 2019; Farrell & Newman, 2019; Gertz and Miles 2020). Despite the EU's status as one of the world's major economic actors, its role in the geoeconomic turn remains under-researched. Meunier and Nicolaidis recently claimed that Europe also uses "economic statecraft to compete on a level-playing field when the breakdown of multilateralism has fragmented the world into regions and rival powers" (2019, p. 103). Indeed, at the EU policy level, there is a notable increase in initiatives that seemingly follow a geoeconomic rationale, such as the recent EU Investment Screening Regulation ("ISR").[1] However, empirical research that systematically assesses how Europe positions itself against the context of a proclaimed geoeconomics shift in practice is missing. One reason for this may be that the empirical application of the literature on the geoeconomic turn so far entails a bias towards cases of *offensive* rather than *defensive* policy: most examples illustrate how states use economic interdependence offensively to further their foreign policy goals. Geoeconomic literature has yet to pay an equal amount of attention to the ways in which states may defend themselves against the use of weaponised interdependence by other states. Yet, as Gehrke notes, the

[1] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union.

"EU is primarily a defensive, rather than offensive actor in the context of geoeconomic competition" (2020, p. 1).

Against this background, this chapter reviews recent European trade and investment policies that presumably follow a *defensive* geoeconomic rationale. Instead of taking the EU's role as a geoeconomic actor for granted, we critically unpack the challenges that Europe faces as it seeks to reduce its strategic vulnerability to economic dependence on others. Conceptually, our approach is a multidisciplinary application of political science, legal, and economic methods. The joint starting point is the conceptualization of the proclaimed geoeconomic shift in international economic relations, understood as "marked by a greater focus on relative—rather than absolute—economic gains" (Roberts et al., 2019, p. 657).

Empirically, to explore our understanding of Europe's (dis)ability to position itself as a geoeconomic actor, we focus first on the ISR, which regulates how Member States scrutinize and block critical Foreign Direct Investments (FDI) by non-European entities. Our second case looks at European FTAs with non-European partners. An important feature in these FTAs is the inclusion of Most-Favoured-Nations ("MFN") clauses, which protect each party to the FTA from the possibility that the other party negotiates more a favourable FTA with a third country. The ability of the EU to enforce these clauses to reap relative gains is yet unexplored. Our third case concerns Europe's response to the BRI, a major infrastructure investment project launched by China in 2013. It takes the division across Member States that either endorse or reject the BRI as a starting point to assess whether the absence of a defensive EU policy leads to relative losses (rather than gains) vis-à-vis China or other non-trade-related risks. In terms of methods and sources, we combine qualitative research, including the analysis of framing based on EU documents and two expert interviews,[2] as well as legal analysis of the instruments, with quantitative analysis. The latter draws on findings reported in empirical (mainly economic) research and on an own assessment of the Member States' differential degree of involvement in the BRI.

[2] The phone interviews were conducted with members of the Directorate-General for Trade at the European Commission, in December 2019 and in January 2020. Both interviews were anonymized.

Our findings are, first, that the EU's own framing of what makes a policy initiative "geoeconomic" varies widely, and does not always correspond to the legal design or economic implications of a given initiative. Second, we find across all cases that institutional challenges undermine the EU's ability to position itself as a geoeconomic actor. Lastly, the case of Europe's reaction to the BRI reveals that Member States may pursue interests that conflict with EU policy initiatives—even if outcomes are welfare enhancing for some sectors.

These findings shed new light on recent debates about the position of the EU in a geoeconomic context. They question the extent to which the EU will be able to "use economic statecraft to compete on a level-playing field" (Meunier & Nicolaidis, 2019, p. 103), without reforms to the existing institutional set-up. In the following, the chapter first presents an overview of discussions on the EU as a geoeconomic actor, followed by the case studies and a concluding section.

The Geoeconomic Turn in World Politics and the EU's Response

Much of the recent literature on the so-called geoeconomic turn in world politics focuses on the United States and its competition with China. Few scholars assess the EU's position from a geoeconomic perspective. Instead, debates focus more generally on how the EU has sought to reposition itself in a changing geopolitical context (Christiansen 2020). In particular, scholars discuss how the EU responded to the changing geopolitical context in the past decade(s) with the pursuit of what is termed (open) strategic autonomy. While the EU has traditionally sought "autonomy through alignment" within an US-led world order, the present phase of global disorder led to calls for an alternative strategy that pursues autonomy more independently of the United States (Lavery and Schmid 2021). The idea of strategic autonomy of the EU originated in the security realm (Smith, 2018), and was inscribed into the EU's Global Strategy (2016), but has since then been broadened to capture other policy areas, including economic relations (see also Schmid et al., this volume).

What does the EU's proclaimed pursuit of strategic autonomy entail in the economic realm? On the one hand, it is geared towards reducing external economic dependencies on others. On the other hand, it is about building internal capabilities, both related to economic capabilities (e.g.

through industrial policies) and through improved internal coordination within the EU to fend off what is perceived as a geoeconomic threat (e.g. the ISR). Along these lines, the EU's New Industrial Strategy (2020) presents initiatives to promote strategic autonomy, which either classify as defensive "efforts to retain existing critical resources and strategic assets", or efforts that are geared towards building capabilities by "secur[ing] critical capabilities and supplies in strategic areas where such resources and assets are lacking" (Pohl, 2020, p. 153).

The application of strategic autonomy to the economic realm resonates with the concept of geoeconomics. It is not identical, however, in the sense that it emphasizes a more defensive, rather than an offensive, position towards economic interdependence. Instead of using economic interdependencies—and the dependence of others on oneself—to offensively pursue strategic goals, strategic autonomy is more geared towards reducing dependencies on others to avoid being subject to the geoeconomic initiatives of others (Koeth, 2021, p. 3).

Yet, it remains contested how exactly the EU should pursue strategic autonomy as a (geo)economic actor. This is in part because of the trade-offs involved in doing so: reducing economic dependencies on others may make sense for strategic reasons, but could entail direct economic costs, for instance, if foreign investments are prevented.[3] The resulting tension between economic and non-economic foreign policy goals is acknowledged in recent attempts at the EU level to rebrand strategic autonomy as *open* strategic autonomy.[4] Lavery, McDaniel, and Schmid (this volume) portray the conflict over how to frame and interpret this concept in EU foreign policy as a struggle between neo-mercantilists and economic liberals that have different visions for Europe's place in the world.

It so far remains unclear whether and why this (contested) shift at the policy level has contributed to building the EU's capabilities as a geoeconomic actor in the twenty-first century. Meunier and Nicolaidis claim that Europe can use "economic statecraft to compete on a level-playing

[3] That non-economic policies may have economic costs is nothing new. Policies restricting economic activity for purposes of environmental protection or the eradication of forced labour, for example, also inflict economic costs. Such costs may be economically justified if they serve to reduce externalities.

[4] With regards to EU–China relations, EU High Representative Joseph Borrell, for instance, acknowledged that reducing economic dependence may not in all instances be feasible or desirable, when stating that "[w]e are too interdependent to decouple economically from China" (Borrell 2020, September 9, p. 9).

field when the breakdown of multilateralism has fragmented the world into regions and rival powers" (2019, p. 103). They prominently refer to the ISR and the new public procurement instrument as examples of rather successful geoeconomic policy initiatives. Others have been more cautious in their assessment. They mention how a lack of unity between the European Commission and the EU Member States shapes, and potentially limits, European power as a geoeconomic actor (Gehrke, 2020, p. 1; Christiansen 2020 on EU-China relations). Olsen introduces the "EU's geoeconomic paradox" (2020, p. 43), which emphasizes how highly independent private-sector actors at the domestic may present a challenge to the EU's geoeconomic ambitions. He concludes that "EU governments hold little direct influence over the management of the very material basis underpinning the geoeconomic interventions for which political demand is rising" (ibid.). This existing literature thus remains not only scarce, but also divided in their assessment of the EU's capabilities as a geoeconomic actor.

Against this background, we investigate more systematically, whether and how the EU acts in a geoeconomic sense. The following case studies examine, first, the existence of a geoeconomic rationale of a given policy initiative, including the EU's own framing thereof; second, the relative (economic) gains at stake; and, third, whether the EU is able to implement a given policy initiative, and if not, what constraints it faces. In doing so, we do not presuppose that the EU *should* act in a geoeconomic way, but instead seek to explain what stands behind its own claims to position itself as a geoeconomic actor that pursues (open) strategic autonomy. The examples have been chosen to illustrate the differing nature of offensive versus defensive geoeconomic tools (and the absence of a unified response/'non-tool' in the case of BRI) and the reality that such tools often are framed as potentially serving both offensive and defensive ends. Compared to other potential examples, such as restrictive measures (economic sanctions), they are a cleaner illustration of economic statecraft, as they are economic policy tools by design, which are used for non-economic ends. Further potential examples are currently not fully operational (e.g. the new EU foreign subsidy regime or the anti-coercion instrument).

The EU Investment Screening Regulation

Investment screening on national-security grounds seems like an intuitive example of a geoeconomic instrument in the sense of being a potential tool of economic statecraft. Yet it remains to be examined how exactly EU countries might use investment screening to further objectives that are not purely economic (i.e. "security-related", "geopolitical", or "geostrategic") and what economic consequences this entails. We argue that while economic costs seem justifiable, its effectiveness as a defensive geoeconomic instrument is hampered by the limited competence granted to the European Commission regarding its implementation.

Investment Screening as a Geoeconomic Instrument: Framing and Legal Framework

Investment screening allows a country to selectively prohibit inward foreign investments[5] that adversely affect its national-security interests or other important national interests ("adversarial capital"). Investment screening differs from ad hoc government interventions (Segal, 2021). Investment screening itself is not a novelty (Muchlinski, 2007), and many countries have operated such for decades (OECD, 2020). More recently the use of, and attention given to, national security as an argument for restricting foreign investments has increased (Aggarwal & Reddie, 2021; Jackson, 2020, February 14). This signals a geoeconomic framing of such instruments. With China's recent emergence as a credible geopolitical rival, the frequency of use and scope of investment screening mechanisms have greatly increased across the globe (Danzman, 2021).

In Europe too, investment screening mechanisms received increased attention and powers in line with its new framing as a geoeconomic instrument (Hindelang & Moberg, 2020).[6] The ISR marks the beginning of a common approach to investment screening within the EU.

[5] Although investment screening can cover any type of inward foreign investments, most investment screening regimes target only foreign *direct* investments (FDI) and sometimes significant foreign *portfolio* investments. Investments deemed insignificant are usually excluded.

[6] Most of the Member States of the EU now maintain general investment screening mechanisms. Some sector-specific investment screening systems exist in almost all EU Member States. Since 2020, the EU has a fully applicable framework in place for coordinating Member States investment screening mechanisms.

While the ISR is not a screening mechanism itself, it is the first attempt to bring the Member States' investment screening mechanisms under a common framework under the EU coordination. The EU itself, acting through the European Commission, is at the heart of the ISR's cooperation mechanism. While the Commission cannot block investments, it is able to analyze foreign investments and recommend Member States to take action. Currently, 18 Member States have investment screening mechanisms, a number that has increased since the ISR came into effect. The remaining Member States nevertheless must have contact points and the ability to actively participate in the cooperation mechanism.

In framing EU investment screening under the ISR as a new instrument of European statecraft, it is important to keep in mind how investment screening functions both in practice and in theory. First, in legal terms, investment screening is a *defensive* geoeconomic instrument. By controlling *inbound* foreign investments, it is a tool to manage the effects of the geoeconomic actions of *other countries*. Although it has been argued that the ISR could be seen as political leverage to ensure reciprocal investment opportunities for EU outward investments (Schill, 2019), its direct concern remains the influx of adversarial capital into the EU. Second, it is the discretionary application of executive powers which allows investment screening to be used as an effective tool of economic statecraft.

Finally, what makes investment screening not just a flexible policy tool, but one that can be used for geostrategic objectives, follows from the purposes set out in its legal framework: to block investments that are "likely to affect security or public order" (Article 4, ISR), including as determined by its effects on critical infrastructure, critical technologies and dual-use items, supply of critical inputs, access to sensitive information, and the freedom and plurality of the media.. The ultimate scope is given by the concept of "security" (and "public order") remains fluid. Since security is not a legal term, but one whose material content is most authoritatively defined politically, its inclusion as key criterion in the ISR signals a legislative intent to preserve a wide margin of executive discretion (Pohl, 2020). This is reaffirmed by the limited practical possibility for foreign investors whose investments have been blocked to pursue legal remedies (Hagemeyer, 2020).

The link to security considerations is also made explicit in the way in which the EU has so far framed the ISR. In the words of Executive Vice-President Valdis Dombrovskis, the ISR seeks to "safeguard key European assets and protect collective security" (European Commission, 2020, October 9). The EU furthermore emphasizes that the ISR "ensures that while remaining open to investment, the EU is equipped to protect its essential interests" (European Commission, 2021, June 22). He further emphasizes that "If we want to achieve an open strategic autonomy, having an efficient EU-wide investment screening cooperation is essential" (ibid.). In the context of the COVID-19 pandemic, the EU further emphasized that ISR seeks "to prevent a sell-off of strategic EU assets in the current crisis" (EU News, 2020). This reflects a concern among Member States about a loss of strategic technological knowledge towards China (Zwartkruis & de Jong, 2020, p. 451). There is a fear of Chinese investments in "EU companies that have technological knowledge that China can use to upgrade its industry" (ibid., p. 453).

Notably, official statements also suggest that the geoeconomic rationale of the ISR is not only understood in line with such "traditional" security-related concerns. Instead, it is also deemed relevant to use the ISR to promote economic reciprocity, i.e. equal market access opportunities for the EU and its economic partners. When referring to "transactions [that] may put our collective security or public order at risk", the Commission services, for instance, emphasize that "[t]his is especially the case when foreign investors are state owned or controlled, including through financing or other means of direction" (European Commission, 2021, June 22, para. I.1). This resonates with what Lavery, McDaniel, and Schmid (this volume) see as a neo-mercantilist, rather than a liberal, perspective of Europe's role in the world.

Economic Implications of Investment Screening in the EU

What are potential economic implications of the ISR, and how do they relate to the EU's proclaimed geoeconomic objectives? The principal economic critique of the ISR is that, although officially framed as originating from a purely strategic political rationale, it could also be a product of rent-seeking behaviour. In any case, it is likely to entail economic efficiency losses and scope for future rent-seeking and collusion that might allow incumbent market leaders to secure monopoly profits by undermining foreign competition. The ISR might also become costly if protected industries cannot attract sufficient non-EU investments. On the other hand, given that the EU is one of the world's most open regions to FDI inflows and it is unclear how large the economic costs of the ISR will be, concerns about losses from "excessive protectionism" might be exaggerated.

Next to these possible costs, there might also be economic benefits, if the ISR secures high standards for critical infrastructure (including food and energy supply, and communication). This can have a positive impact on the investment climate due to higher economic and legal certainty. Moreover, the ISR might prevent that frontier technologies are costlessly transferred out of the EU, post-acquisition. This might occur, for example, if an investment includes the acquisition of intellectual property (IP) and thereby the rights for its future use. If the EU is in a technologically leading position, keeping decisions on how and where to use their IP in Europe could preserve its own (potentially offensive) geoeconomic capacities and be in line with the geoeconomic rationale of the ISR. The economic costs of the ISR could, hence, be justified it if it generates positive externalities that compensate these potential losses.

The Implementation of Investment Screening in the EU

With investment screening in principle being able to serve as a geoeconomic instrument, how useful is the ISR for the purpose of implementing EU geoeconomic policy? This question has two parts: (1) it needs to be addressed what a useful application of investment screening as a geoeconomic instrument would look like; and (2) it remains to be evaluated whether there are any structural or functional limitations preventing the EU from using investment screening as an instrument to act geoeconomically.

As to the first part, to be a useful defensive tool, investment screening must be capable of preventing foreign acquisitions of critical military or dual-use resources (strategic assets) with a view to deny, restrict, or place conditions on their continued availability to the host state (Moran, 2009), and by so doing obtain diplomatic leverage. However, the concept of security has over time expanded beyond the ability to prevent, withstand, and recover from the threat of armed confrontation to cover a range of other types of hostile or otherwise harmful potential behaviour of others. Such hybrid threats include political warfare, cyberwarfare, lawfare, and economic warfare (Hoffman, 2007; Reichborn-Kjennerud & Cullen, 2016, February 26). It is thus unsurprising that the scope of investment screening extends far beyond military or dual-use infrastructure, technologies, and supplies. Adversarial capital may also be invested to obtain political influence through the ability to deny, restrict, or place conditions on the continued availability of any economically critical resource or through access to sensitive information. In addition, such investments may serve to obtain market power, to undermine the geoeconomic diplomacy of the host state, to gain access to personal data for purposes of data-mining activities and big-data intelligence gathering, or to establish a media platform for disinformation purposes (Leonard et al., 2019, June 25). The usefulness of investment screening mechanisms as geoeconomic instruments depends on their effectiveness in defending against the full range of such hybrid-threat scenarios.

As to the second part, at the implementation level, the ISR enables the EU to identify and assess both traditional and hybrid security threats. Nevertheless, investment screening could not justify arbitrary discrimination or disguised restrictions of the free movement of capital. Rather, to block an investment there must be a genuine and sufficiently serious threat to a fundamental interest of society and, moreover, those grounds must not serve purely economic ends and must comply with the general principles of EU law (Hindelang, 2009).

EU law provides a robust system of judicial review that provides safeguards against abusive application of the ISR. Apart from having a right to legal recourse against investment screening decisions, private-sector actors are not assigned any role under the ISR. There is no right to petition investment screening authorities to investigate a foreign investment or investor. The risk that private-sector actors would engage in rent-seeking behaviour, such as by being able to direct investment screening against commercial rivals and to pursue private interests unrelated to EU interests, remains but does not arise specifically from the design of the ISR.

The EU's ability to use the ISR as a geoeconomic instrument is significantly restricted by the fact that the European Commission is not empowered to authorize, prohibit, or impose conditions on, foreign investments under the ISR. Its coordinating role is challenging as it depends on the ability and willingness of Member States to share sensitive information on FDI (Zwartkruis & de Jong, 2020). Such powers remain exclusively reserved for the Member States. The European Commission is limited to delivering opinions to which the Member States are obliged to take into consideration (Pohl, 2021). The role of the European Commission is thus to actively work together with the Member States to forge common positions (cf. BRI case). This is obviously a far cry from being able to control the use of investment screening as a geoeconomic instrument and represents the principal challenge for the EU to act geoeconomically in defending against inward investments of adversarial capital.

Interim Conclusions

The ISR can in principle be operated as a defence against geopolitically motivated foreign investments. Such investments can take many forms, which is why investment screening is and must remain a flexible tool. Economic costs are also likely to be negligible compared to the potential security-related gains. Rent-seeking in connection with investment screening is not excluded, but nor is it facilitated by the design of the ISR. However, the ISR's effectiveness as a geoeconomic instrument is hampered by the limited competence granted to the European Commission.

The EU's Use of Most-Favoured Nations Clauses in Its Free Trade Agreements[7]

While MFN clauses are common in EU FTAs, they have received little scholarly attention. So far, they have not been studied as geoeconomic policy instruments. We argue, however, that the rationale for the inclusion of MFNs in EU FTAs follows a geoeconomic emphasis on relative gains vis-à-vis strategic competitors. Their economic implications, however, remain unclear and their implementation remains sketchy, which undermines their effectiveness.

The Geoeconomic Rationale of MFN Clauses in Free Trade Agreements: Framing and Legal Framework

In the post-World War II era, the MFN principle had traditionally not been used for geoeconomic purposes. Instead, it has come to serve as a cornerstone of the multilateral trading system. The general MFN clause of Article I of the General Agreement on Tariffs and Trade (GATT) obliges

[7] Note that this case study draws on Bohnenberger and Weinhardt (2022).

regime members to "immediately and unconditionally" extend market-opening concessions to "all other contracting parties". In this way, the MFN clause prevents WTO member states from discriminating others: all market access concessions offered to one member state are immediately extended to all others.

The rationale for using MFN has only changed in the past decades, as it became a common practice to include MFN clauses in Free Trade Agreements. This development was facilitated by the general rise of FTAs that are negotiated outside of the multilateral realm of the WTO. In contrast to the multilateral level, their use in bilateral settings reflects primarily a geoeconomic rationale (Bohnenberger and Weinhardt 2022). This is because MFN clauses can be used strategically to protect FTA members against economic competitors: If any of the partners were to offer better market access to another party in the future, these new concessions would need to be passed on to the members of existing FTAs with an MFN commitment. They thus help to "lock in" a privileged trade relationship and reflect the intention to secure relative gains vis-à-vis strategic competitors. Given that the multilateral trade negotiations continue to be blocked, it is likely that the trend to include MFN in various FTA chapters will continue and possibly intensify in the future (Interview 2, EU trade official).

In principle, MFN clauses hold both the potential to serve as an *offensive* geoeconomic policy instrument—securing better market access in the future, but also a *defensive* one: to protect against relative losses vis-à-vis strategic competitors that may conclude a (better) FTA with an EU trading partner in the future. This dual reasoning was echoed in the interviews. An EU trade official claimed in an interview that "the EU now includes MFN clauses in many of its FTAs to ensure its competitors cannot negotiate better market access" (Interview 1, EU trade official, by phone, 19.12.2019). In negotiations of the EU-Korea FTA, for instance, the EU included MFN in the services and investment chapters to ensure that European companies would not be treated any worse than their US competitors (Interview 1). Another EU trade official similarly emphasized that the MFN clause should be actively used to protect the EU from its trading partners such as the United States and China (Interview 2, EU trade official, by phone, 14 Januray 2020). The EU-Mercosur FTA, for instance, contains MFN clauses that apply to public procurement, which would guard the EU against a scenario in which Mercosur countries offer better access to China in the future. This turns MFN clauses in FTAs into a potential instrument in the sense that it can be used to maximize relative gains vis-à-vis strategic competitors.

When considering the legal framework governing their use, MFN clauses are a readily available policy instrument. The EU enjoys exclusive competence to act in the area of the EU's common commercial policy, which includes the conclusion of FTAs, with only certain limitations, such as the inclusion of certain investment-related provisions. In contrast to the ISR, MFN clauses related to trade in goods and services belong to the areas where the European Commission can act without the need for involvement of the Member States.

Economic Implications

MFN clauses in EU FTAs are a relatively common empirical phenomenon, which renders it important to assess whether their economic implications are in line with their proclaimed geoeconomic rationale. The European Union is—next to the United States, Japan, and Canada—among the major trading nations that most frequently include MFN clauses in their FTAs. A substantial amount of the chapters on services trade and investment in EU FTAs, for instance, include MFN clauses (see Table 5.1). Beyond these chapters, MFN clauses can also apply to trade in goods, public procurement, or other regulatory measures like taxation and the protection of intellectual property rights. Indeed, most EU FTAs contain MFN clauses in some form (Magntorn, 2018).

Table 5.1 MFN clauses in services and investment chapters of EU FTAs (Based on Bohnenberger and Weinhardt, 2022)

Country	*Number of FTAs (only base treaties without amendments or accessions)*	*Services (with services chapter/with MFN clause)*	*Investment (with investment chapter/with MFN clause)*
EU	>80[a]	46[a]/16	16/11

Source Own compilation based on DESTA data. Note on coding the data: services chapters are counted if they are coded as '2' in DESTA, which equals "Substantive provisions liberalizing trade in services". Investment chapters are counted if coded as '4', which equals a standalone investment chapter "Beyond services"

[a]Counting the number of EU agreements is tricky as it includes all sorts of regional integration, association, and partnership agreements with a trade component (Bohnenberger and Weinhardt 2022).

The economic implications of wide-spread MFN clauses in EU FTAs are difficult to generalize and would require a case-by-case evaluation. MFN clauses cannot per se guarantee any particular volume of market transactions (absolute gains) or even market shares (relative gains) to negotiating parties. Instead, they ensure that the absolute intensity with which countries trade or otherwise economically interact is determined by conventional forces of demand and supply that would also be at work in freely operating markets. To this end, MFN clauses are a tool to promote trade/treaty multilateralism, as they become part of ever-increasing numbers of bilaterally negotiated agreements. They do not create or prevent any directly economic dependencies that could be attributed to an underlying geoeconomic strategy. Only if the inclusion of MFN clauses reveals as an effective tool to promoting deeper trade/investment agreements between negotiating parties, such dependencies can result as an indirect effect by facilitating the inclusion of additional privileges and concessions that would otherwise not have been part of a treaty.

The Implementation of MFN Clauses in EU FTAs: Living up to Their Purpose?

The practical implications of existing MFN clauses in EU FTAs are often unclear and, partly as a result, their potential to act as a geostrategic tool remains largely untested. The implementation of MFN clauses in EU FTAs seems very limited. One indication is that there are so far no legal disputes regarding the enforcement of MFN obligations in bilateral or regional FTAs (Interview 1, EU trade official). While some of the FTAs that include MFN clauses might simply be too recent, this nonetheless suggests uncertainty regarding their actual implementation. According to an EU trade official, there is no precedent for the application of an MFN clause in any of the EU FTAs (Interview 2, EU trade official). This lack of actual use raises questions about their effectiveness as a strategic tool to secure relative economic gains against competitors.

To what extent does this lack of implementation of MFN clauses reflect the particular challenges that the EU faces as it seeks to act in a geoeconomic way? With regard to private-sector actors, rent-seeking or simply competing interests do not seem to play a role. For MFN clauses in investment chapters, this is simply a matter of design: rent-seeking seems excluded by the fact that they are designed to be enforced by private investors. Thus, there is no misalignment of interest if private-sector actors pursue investment claims under a FTA investment chapter. As for MFN clauses in trade chapters, there could be a rent-seeking problem, if firms put pressure on the EU not to push for implementation of an MFN clause to weaken economic competitors.

However, the problem behind the low levels of implementation of MFN clauses seems to be primarily one of missing information rather than rent-seeking: firms may not even know if they miss out on market opportunities under MFN clauses that are not implemented. This is partly explained by a lack of systematic monitoring at the EU level of trade partners' compliance with MFN obligations (Interview 1, EU trade official; Interview 2, EU trade official).[8] As a result, private-sector actors may not even now know when their rights to more favourable market access conditions are not respected, which in turn explains the lack of dispute settlement cases over MFN clauses in EU FTAs. As one interviewee speculates, we might "see no cases [because] we do not know about better market access granted elsewhere" (Interview 2). Conversely, divergence between Member State interests does not seem to be an impediment for the implementation of MFN clauses.

One reason for the lack of systematic monitoring is the complexity of such an undertaking, which would entail close monitoring of the commitments that trade partners make to third countries. Especially for services and other areas of regulatory complexity, this would be quite difficult to establish across the board. In other words, MFN clauses might exist on paper, but neither the traders that might potentially benefit from them, nor their governments can comprehensively monitor trade partners' liberalization commitments with third parties. Another reason could be that the FTA MFNs are not considered important for the EU vis-a-vis a particular third country. This would, however, only hold for FTAs with smaller economies—and not, for instance, regarding those with Canada, South Korea, or Japan.

Interim Conclusions

To sum up, these findings indicate that while the EU frames the use of MFN clauses in FTAs as geoeconomic instruments, the absence of clear economic trade-offs and remaining implementation challenges make them rather ineffective.

[8] Not that as concerns investment MFNs, it is the responsibility of the investor to monitor MFN compliance and take action if necessary.

Europe's (Non-)response to China's Belt and Road Initiative

The BRI is a transcontinental infrastructure development plan promoted by the Chinese government since 2013. It consists of numerous projects involving countries on almost all continents. The so-called *Eurasian Land bridge Corridor* is the part of the BRI that connects China with the EU via direct railway connections. This case study takes the lack of a unified European response to the BRI as a starting point to assess whether the engagement of individual Member States with the BRI indeed has economic implications that resonate with existing perceptions of geoeconomic risks at the EU level.

China's Belt and Road Initiative and the Geoeconomic Rationale of Europe's Divided Response: Framing and Legal Framework

At the EU level, the BRI reveals as an ambiguous issue. A joint statement after Chinese President Xi Jinping's first visit to the EU in 2014 declared vaguely that both parties will seek to "develop synergies" between their respective transport and infrastructure policies and "to explore common initiatives along these lines" (European Commission 2014, March 31). In the meantime, a divided European response has been driven by both EU-level initiatives and Member States' individual engagements with China on the BRI. At the EU level, the EU-Asia connectivity strategy (2018), the communication on "EU-China – A strategic outlook" (2019) and the recent announcement of EU Foreign Ministers to launch the EU's own infrastructure plan (Emmott & Siebold, 2021, July 12) stand out. At the same time, several Member States—including Italy as a G7 member (see Table 5.2, Appendix, for an overview)—embraced the BRI and signed bilateral Memoranda of Understanding (MoUs) with China that envisage its joint promotion. Other Member States are wary to actively support the BRI and prefer a unified EU-level response.

With regard to the EU's own framing of cooperation with China on the BRI within Europe, there exists no formal assessment of its risks and opportunities at the EU level (ECA, 2020, p. 48). What is notable, however, is that the communication on "EU-China – A strategic outlook" (2019) portrayed China not only as a "cooperation partner", but also as an "economic competitor" and as a "systemic rival promoting alternative models of governance" (ECHR, 2019, March 12, p. 1). This framing signals that economic cooperation with China—including via the BRI—may carry political risks. The EU's recent own infrastructure initiative explicitly seeks to promote a "principled" EU model—which is understood to contrast with the BRI approach (Emmott & Siebold, 2021, July 12). In general, a key political risk associated with BRI investments in Europe is, similar to the ISR case, the fear that "Chinese investments in sensitive/strategic assets in Europe may affect security/public order" and undermine European unity (ECA, 2020, p. 35).

The economic implications of the BRI are, moreover, framed as risks factors for the EU. In particular, the BRI is commonly linked to the theme of "economic reciprocity" and "a level playing field" that featured prominently in the EU's New Industrial Strategy (2020). Along these lines, all ambassadors from EU Member States to Beijing—except for Hungary—signed a statement in April 2018 saying that the BRI "runs counter to the EU agenda for liberalizing trade and pushes the balance of power in favour of subsidized Chinese companies" (Heide et al., 2018, April 17). This framing clearly reflects concerns about relative gains for China vis-à-vis Europe. Yet, no uniform framing exists at the European level since some Member States, especially in Eastern Europe, welcomed the BRI, while others—notably France—remain highly critical of what is seen as a "one-way" road towards "hegemony" and political dependence on China (statement by President Macron, quoted in Carnegie, 2018, October 18).

The reasons for the ambivalent response at EU level relate both the legal framework, but also divergent Member State interests. At the legal level, the response to the BRI touches upon issues where the European Commission and Member States both hold competences. While the European Commission holds exclusive competence in areas such as competition rules, in areas such as energy and transport both can pass laws, which makes a unified approach difficult. National security, moreover, is an exclusive competence of the Member States (ECA, 2020, p. 33), which makes it difficult to arrive at a shared assessment and unified approach regarding potential security risks associated with engagement with the BRI. The reason for this is to be found in the institutional arrangements governing the Common Foreign and Security Policy (CFSP), which is based on the principle of intergovernmentalism. This means in practice that each Member States retains an individual veto on CFSP matters. Any policy coordination on an EU level therefore requires unanimity among the Member States to reach decisions in the

Council of the European Union, although once agreed, certain aspects can be further decided by qualified majority voting. This hampers the EU's ability to act geoeconomically in the field of CFSP, starkly illustrated in the case of the EU's response to the BRI. Moreover, this division seems to reflect a differential evaluation of the BRI across member states based on economic interests (Pomfret, 2019).

Economic Implications: International Trade and Economic Asymmetry in EU-China Relations?

Does the engagement of individual Member States with the BRI indeed have economic implications that would strengthen China as an "economic competitor" and further tilt the "level playing field" in favour of China? One way to assess the economic implications of BRI-engagement of EU Member States is to analyze how it affects patterns of international trade. As an infrastructure project, the BRI has direct implications on trade costs (De Soyres et al., 2019), which imply lower prices and efficiency gains, but also through shorter delivery times and access to a wider range of product varieties. The EU's economic position relative to competitors outside the BRI network will be improved (Li et al., 2018; Mau & Seuren, 2022). Economic adjustments and new specialization patterns within the network will lead to mutual gains among participating countries, but their relative size and distribution are difficult to predict.

Overall, the BRI promises classical efficiency gains from trade for European economies. Improved market access in China and other Asian economies leads to economies of scale and higher accountability and planning security for the organization of decentralized production processes and supply chains. These gains will materialize in industries where rail transport offers a profitable alternative to conventional long-distance transportation modes. As shown in Table 5.2, countries signing BRI-related Memorandas of Understanding with China also report related investment inflows and construction projects, as well as economic specialization in industries that are likely to benefit from new railway connections.[9] Countries lacking sound economic fundamentals, strong institutions, and appropriate governance to prevent corruption and public

[9] The latter is inferred by a higher revealed comparative advantage (RCA) score of these countries. The construction and exact interpretation of this measure is explained in the Appendix.

procurement failures are, however, less likely to benefit (Ruta et al., 2019, June 18).

There are little gains to be expected in terms of knowledge or technology transfer, given that EU economies are technological leaders among the BRI economies. China is likely to benefit more in this respect and be able to promote economic development in many of its less developed inland regions. The BRI may therefore strengthen China's overall economic position relative to the EU in this regard, and possibly emerge as an economically equally important partner for Europe than the United States and other advanced economies are. Similarly, as Europe will be able to secure market shares in China and several other Asian economies it might be able to strengthen its strategic economic position both in absolute terms and also relative to any non-BRI economies. In general, however, trade-related economic effects remain rather marginal and are therefore unlikely to present a geoeconomic risk for the EU.

Assessment of Risks of Economic Dependence Associated with the BRI

While a functioning and modern infrastructure can facilitate countries' ability to extract benefits of the BRI, their high financial costs—requiring public expenditure and debt—entail the risk of turning into unsustainable investments. The resulting economic integration of the Eurasian landmass will consequently entail also increased scope for geoeconomic policy and a "weaponization of interdependencies" (Farrell & Newman, 2019)—e.g. related to the reliability of the BRI railway networks or a reliance of some EU Member States on Chinese funds for infrastructure investments. While the former remains speculative, the latter aspect is important regarding geoeconomic risks associated with increased economic dependence on China: Next to the several direct and indirect (mostly positive) economic effects, participation in the BRI is also costly. It requires large-scale investments that are often combined with financial commitments towards China. The World Bank (Ruta et al., 2019, June 18) report highlights this as an important macroeconomic risk factor, especially for developing countries. Also, European economies report increasing foreign investment and capital inflows from China. According to recent estimates by Horn et al. (2020), debt stocks towards China in five non-EU West-Balkan economies amount to about 7.5% of their GDP on average.[10] This can create significant dependencies—not only financially—which call for a high level of scrutiny and alertness, according to several observers, due to China's lending practices and general cultural distance to Europe (e.g. Mardell et al., 2018, June 26; Gelpern et al., 2021, March 31).[11] A potential political risk that results from increased engagement with the BRI thus is the (unilateral) reliance of some EU Member States on Chinese funds for infrastructure development.

Indeed, data from the *China Global Investment Tracker* (AEI, 2021) suggests that the BRI plays a major role in China's investment activities in Europe. About half of Chinese FDIs transactions under the BRI stem from SOEs rather than private business (ECA, 2020, p. 22). However, total flows remain fairly small compared to Europe's aggregate volume of foreign investment inflows. OECD (2021) statistics suggest that China's share in cumulative FDI inflows during the period 2013–2019 accounted for less than 2.1% of total inflows in an average EU member state. Only three countries report shares of 5% or higher (i.e. Portugal, Hungary, and Sweden). For comparison, FDI inflows from the United States ranged at 7% on average so that the scale China's overseas investment activities are still comparatively minor.

Interim Conclusion

Altogether, while the BRI might generally constitute a powerful channel for geoeconomic policymaking in Chinese interests including in Europe, the engagement of individual Member States with the BRI does not appear to live up to the framing of the BRI as a geoeconomic risk. The main reasons are that the economic importance of the BRI as a trade channel is relatively minor. The same holds for its investment volumes, even though they might grow in the future and the assessment might depend on where such investment takes place (see first case on IRS). In

[10] Numbers are based on own calculations using information from the *China Debt Stock Database* (Horn et al., 2020). Non-EU West-Balkan economies refer to Albania, Bosnia-Herzegovina, Northern Macedonia, Montenegro, and Serbia.

[11] Gelpern et al., (2021, March 31) document Chinese lending practices, terms, and conditions based on a unique set of original contracts between Chinese state-owned enterprises and government borrowers in various developing and emerging economies.

fact, the BRI could turn out as a catalyst for improved European access to markets across Asia and actually strengthen its political bargaining position in this region. Only small and/or financially vulnerable EU economies might be more exposed to the threat of economic dependence on China.

Conclusion

This chapter has revisited three EU trade and investment policies to assess its capabilities as an actor in a geoeconomic context: the Investment Screening Regulation, the use of Most-Favoured Nations clauses in FTAs, and Europe's (non-)response to China's Belt and Road initiative. We find that the EU's ability to act in line with its geoeconomic ambitions varies across the cases but remains relatively low. Implementation levels do not correspond to the geoeconomic ambitions voiced at the policy level, as demonstrated both by the ISR and the MFN cases. We also find that these challenges are driven in particular by institutional factors that set the EU apart from countries such as the United States and China. Both the ISR and the BRI cases illustrate that the lack of competence of the European Commission to act with sufficient autonomy from the Member States in matters of foreign investments is undermining the EU's ability to position itself as a *defensive* geoeconomic actor—albeit this may be less necessary concerning the BRI.

Moreover, the EU's own framing of the geoeconomic rationale of a given policy initiative does not only vary but is not always in line with the legal design or economic implications of a given initiative. More traditional security-related foreign policy goals co-exist with neo-mercantilist framings of the need to establish a "level playing field", in particular vis-à-vis China. Yet, what is conceived as a geoeconomic initiative or threat does not necessarily turn out to be one in practice: neither the use of MFN clauses in FTAs is likely to yield significant relative economic gains, nor does the engagement of individual Member State's with China's BRI necessarily constitute a geoeconomic threat—as long as participating European countries remain financially independent.

These findings shed new light on recent debates about the position of the EU in a geoeconomic context. In contrast to Meunier and Nicolaidis (2019), our findings suggest that the EU faces additional challenges related to its institutional set-up that may at times impair its ability to "use economic statecraft to compete on a level-playing field" (Meunier &

Nicolaidis, 2019, p. 103). The discrepancy between the policy level and the implementation levels, moreover, at times also reveals a misconception about what constitutes a geoeconomic threat (e.g. BRI case) and a suitable instrument to address it (e.g. MFN case). Lastly, more research is needed to complement the existing literature's focus on offensive geoeconomic instruments (Farrell & Newman, 2019) to also capture defensive ones.

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Appendix

See Table 5.2

Table 5.2 EU member and neighbouring countries and their BRI involvement

Country	***"de-jure" involvement*** *signed MoU on BRI collaboration*	***de-facto involvement*** *BRI-related Chinese direct investment or construction contracts*		***RCA in*** *RTA industries*
		volume (million USD)	*share of total*	*weighted sum*
Austria		230	1.00	**11.1**
Belgium				7.4
Bulgaria	2015	130	1.00	**15.6**
Croatia	2017	690	1.00	**12.6**
Cyprus		170	1.00	3.3
Czech Republic		860	1.00	**17.3**
Denmark				6.8

(continued)

Table 5.2 (continued)

Country	***"de-jure" involvement*** *signed MoU on BRI collaboration*	***de-facto involvement*** *BRI-related Chinese direct investment or construction contracts*		***RCA*** *in RTA industries*
		volume (million USD)	*share of total*	*weighted sum*
Estonia				**12.0**
Finland				**11.9**
France				8.6
Germany				**12.1**
Greece	2018	4,500	1.00	5.5
Hungary	2015	2,400	1.00	**13.8**
Ireland				2.8
Italy	2019	23,200	0.95	**12.4**
Latvia	2016	110	1.00	7.0
Lithuania				**10.2**
Luxembourg	2019	4,680	1.00	3.5
Malta	2018	440	1.00	5.2
Netherlands				5.0
Poland	2015	2,150	0.79	**14.1**
Portugal	2018	4,430	0.98	**11.8**
Romania	2015	810	1.00	**16.4**
Slovakia	2015			**15.8**
Slovenia		2,180	1.00	**15.8**
Spain				7.5
Sweden				8.7
United Kingdom[a]				6.2
Albania	2017			
Bosnia-Herzegovina	2017	1,960	0.88	**22.7**
Montenegro	2017	1,220	1.00	
North Macedonia		650	1.00	**11.3**
Serbia	2015	9,600	0.97	**20.4**
Belarus		1,890	1.00	
Ukraine		3,280	0.93	

Note Authors' compilation-based information retrieved from www.beltroad-initiative.com (accessed 14 July 2021) and data from the *China Global Investment Tracker* (AEI, 2021). Investment data restricted to period 2013–2020. Investment volumes are expressed in million US dollars. RCA reflects weighted sum of employment-based industry-level RCAs, where weights reflect fraction of RTA subsectors in NACE Rev.2 level industries. Bold numbers indicate above EU-median RCA

[a]United Kingdom formally left the EU as member state on 31 January 2020

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