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POORLY TIMED OR ACCORDING TO PLAN?

Explaining the motivations and interests of the European Union regarding the new investment agreement with China

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Abstract

At the end of 2020 the European Union (EU) concluded the Comprehensive Agreement on Investment with China that had been seven years in the making. However, the agreement could not have come at a more conspicuous timing, as the EU's stance towards China and its economic practices is hardening, and before the newly elected Biden administration was inaugurated. There has been a dearth of theoretically informed political science research regarding the EU's ten year's old competency over investment. This thesis aims to fill the gaps by utilizing a contrasting approach of neo-mercantilism and liberal institutionalism in order to explain why the EU decided to conclude the agreement and provide a systematic overview of EU-China investment relations. In order to empirically test the hypotheses deduced from the theories, the research employs process-tracing and document analysis. The thesis concludes that the explanatory narrative grounded in neo-mercantilism provides for a sufficient explanation of the research question and is supported by the empirical record. The EU had to secure its geo-economic interests in the growing Asia Pacific and its most important economy, boost the competitiveness of its top performing businesses in the largest consumer market, and reach parity with the US in order to not be economically disadvantaged and potentially confront China as equals. Neo-mercantilism rightly emphasized dominant business interests, relative power considerations and distrust to explain the choice by the EU to conclude the agreement.

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List of abbreviations and acronyms

BIT	=	Bilateral Investment Treaty
CAI	=	Comprehensive Agreement on Investment
CETA	=	Comprehensive Economic and Trade Agreement
CPO	=	Causal Process Observation
CPTPP	=	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
EC	=	European Commission
EP	=	European Parliament
EU	=	European Union
FDI	=	Foreign Direct Investment
FET	=	Fair and Equitable Treatment
FTA	=	Free Trade Agreement
INTA	=	International Trade (commission)
ISDS	=	Investor-State Dispute Settlement
JV	=	Joint Venture
MFN	=	Most Favoured Nation
MOFCOM	=	Ministry of Commerce (China)
NT	=	National Treatment
PCA	=	Partnership and Cooperation Agreement
PRC	=	People's Republic of China
RCEP	=	Regional Comprehensive Economic Partnership
SSDS	=	State-to-State Dispute Settlement
TFEU	=	Treaty on the Functioning of the European Union
WTO	=	World Trade Organization

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Introduction

On December 30th 2020 the European Union (EU) and the People's Republic of China (PRC) reached an agreement in principle on investment, seven years after the negotiations had started (European Commission, 2021a). For the first time the EU has concluded a standalone investment treaty. The 2009 Treaty of Lisbon expanded the scope of responsibilities of the EU's common commercial policy, which since then includes issues related to Foreign Direct Investment (FDI), an area which had previously been the prerogative of the member states. This has given the European Commission (EC) the power to negotiate trade agreements that include investment provisions, or separate investment treaties (TFEU art. 207(1), 2008). In a 2010 communication, titled; 'Towards a comprehensive European international investment policy', the EC detailed its vision and guiding principles of EU investment policy. The EC defined FDI as having the aim of establishing "lasting and direct links with the undertaking to which capital is made available in order to carry out an economic activity" (European Commission, 2010, p. 2). The EC explicitly stated that "openness" is the cornerstone of EU investment policies, while also emphasizing the need for equal market access and fair competition (*ibid.*, p. 4). Furthermore, the Communication set the agenda on the short and medium term by pointing towards – *inter alia* – the prospective EU-Canada (CETA) and EU-Mercosur trade agreements as candidates for adding investment chapters as well. At the time, China was noted as "a candidate for a stand-alone investment agreement" (*ibid.*, p. 7).

Negotiations with China started in 2013, at a time when the EU looked favourably and hopefully upon cooperation with China, as the EU-China 2020 Strategic Agenda for Cooperation adopted by both parties demonstrates (EEAS, 2013). More recently, the EU-China Strategic Outlook by the EC (2019) struck a completely different tone and labelled China as both an 'economic competitor' and 'systemic rival' and berated China for failing to live up to its promises of economic reform. EC President Ursula von der Leyen stated as late as September 2020, that China needs to "convince us that it's worth having an investment agreement" (Tiezzi, 2021). It points to a pattern of behaviour of the EU vis-à-vis China that has changed remarkably. The EU has shored up its defences by creating a new common FDI screening mechanism, which came into force on 11 October 2020, and created the position of Chief Trade Enforcement Officer (CTEO), to which the Frenchman Denis Redonnet was appointed on 24 July 2020 (European Commission, 2020a). It is generally assumed that the screening regulation is aimed primarily at Chinese state-owned enterprises (SOEs), buying up European companies to gain

market access and technological capabilities (Kao, 2019). Similarly, a report by the DG Trade identified China as the country which has the most trade restrictions and barriers, and as such a key point of concern for the CTEO (European Commission, 2020d). Additionally, the EC has proposed and enacted various new trade defence instruments since 2019, such as the reformed EU trade enforcement regulation, a regulation of foreign subsidies and the International Procurement Instrument (Titievskaja, 2020, EUR-Lex, 2021, European Council, 2021, European Commission, 2021b). The shift in the EC's approach to China marks a turning point, moving away from the longstanding neoliberal open markets and open investment approach, towards perhaps a more protectionist stance.

Over the past years the EU's erstwhile largest trading partner and closest ally, the United States (US), has waged a trade war with China and promulgated economic decoupling from China. The incoming Biden administration signalled a desire to coordinate action regarding China, but the EC passed up on the offer and concluded the agreement (Wiseman, 2021). Moreover, civil society, but also the European Parliament, have become vocally attentive and critical regarding China's treatment of minorities – like the Uighurs in Xinjiang – Hong Kong and its international conduct (Tiezzi, 2021). Prominent politicians have warned about the signal it would send to the world if the EU would agree on an investment agreement at this juncture (Bütikofer, 2020; Rafaela, 2021). Previously, internal discord and outside pressure had led to a reversal of course by the EC. A case in point is the exclusion of an investment chapter in the EU-Mercosur trade agreement, despite the original intent (European Commission, 2019a). However, in spite of the EU's changing stance on unrestricted investment, internal and outside pressures, the EU still decided to push ahead with the negotiations and conclusion of the CAI. This has led to the following research question:

Why did the EU proceed with concluding the Comprehensive Agreement on Investment despite the growing distrust within the EU towards China?

In the academic literature, the agreement has not yet received much coverage. The EU and China had reached an agreement on principle on 30 December 2020 and literature on the politics surrounding this specific agreement is still in its infancy (Wang & Li, 2021). References to the negotiations of the BIT have been made in passing only and none have questioned the motivations of either the Commission or China (Wu, 2020). On the other hand, there have been many comparative legal analyses regarding China's evolving investment protection standards and the consistency between BITs of China and various EU member states (Berger, 2008; Zhang & v.d. Bulcke, 2014; Titi, 2015; Huang, 2016; Harpaz, 2016; Cohen & Schneiderman, 2017).

Nevertheless, there is a burgeoning literature on European outbound FDI (OFDI) and inbound FDI (IFDI), especially as it pertains to China. Most of the literature stems from scholars from the disciplines of law, economics and principally political sciences. The business/economics literature tends to rely on complex econometric modelling of expected future mutual benefits for GDP growth or provide policy recommendations based on production network analyses (Barbier-Gauchard et al., 2020; Yildirim et al., 2018; Cappariello et al., 2020; Hanemann & Huotari, 2018; Bickenbach & Liu, 2018; Clegg & Voss, 2011). Economists provide important data and insights on the growth of trade and investment (flows) and the determinants and attraction of FDI (Oxelheim & Ghauri, 2008; Apoteker et al., 2013; Dorakh, 2020, Kirkegaard, 2020, Ali & Guo, 2005). Shortcomings in the literature include the highly technical nature of a significant amount of the studies, disregarding power relations and political struggles. The Sino-European trade relation is very comprehensive and economically important, the literature could have a cross-sectional influence on disciplines but is hampered by its lack of political context. State presence, whether in China or the EU, is always political, social scientists always have to be aware of the political context. Since most English-language work is published by Western economists, the eye tends to be directed at China and the perceived weaknesses (and strengths) of the Chinese economic model. Unlike the legal and political science literature, the economists do frequently employ an explicit (positivist) theoretical model to analyse and support their quantitative modelling. Theories such as Neoclassical Trade Theory, New (new) Trade Theory, theories of industrial organization and strategic rivalry theory, have been utilized. Oftentimes these theories are grounded in microeconomics and the decisions of firms and individuals under perfect competition, which is unhelpful for solving the research puzzle at hand. Furthermore, trade theories cannot accurately capture the complexity that encompasses the politicized economic aspects of the of the Sino-European relationship.

The legal literature has provided valuable insights about questions of exclusive and shared powers between the EC and member states regarding trade and investment (Shan & Zhang, 2010). Particularly, a focal point of analysis among legal scholars has been Article 63 TFEU on the prohibition of restrictions on the freedom of capital clashes with nascent mechanisms for screening FDI (Chaisse, 2012; Schill, 2019; Anwar, 2012; Wu, 2020; de Jong & Zwartkruis, 2020; Cremona, 2017). Similarly, the (potential) role and powers of the European Court of Justice, which has the potential to undermine the leverage of the EC in this field, has been scrutinized (Gadocha, 2020). Furthermore, legal scholars have extensively reviewed the

EU FDI Screening Mechanism; assessing the strength of the regulation, and its role vis-à-vis national screening regulations (Kao, 2019; Weiß & Furculita, 2020; Gadocha, 2020; Barowicz, 2020; Warchol, 2020). A recurring point of critique is the lack of attention regarding the existing European-Chinese BITs and how they are affected by attempts by the EC to protect the single market and restrict the free flow of capital. Chinese law professors have done useful analyses over the years during the process of CAI's negotiation, looking at investment protection in China (Shan & Wang, 2015; Shan et al., 2012; Shen, 2018; Shan & Zhang, 2013). Legal scholars – compared to economists – attended more to the political context in their analyses, since the content and evolution of law results from the political process. Legal scholars tend to occasionally be political actors themselves, being simultaneously involved in professional groups that give policy advice and therefore a stake in the issues on which they write. However, any regard for the political nature of the law(s) is accepting of the status quo and not critical in nature, nor analytical in a systematic manner.

Thus, we observe that both the economic and legal literature provide useful insights into the European and Chinese economic and legal contexts together and separately. However, the legal scholars are more applicable to the case at hand, considering the economists neglect of politics, there still is a lack of theoretically informed research. Neither of the reviewed literature expounded a contradiction. Schill (2019) did detail how the FDI screening mechanism can be utilized to strengthen the EU's hand in negotiations regarding external investment liberalization, to guarantee; “a level-playing field between the EU and other major economic powers, such as the United States or China, in order to negotiate, on the basis of reciprocity, an opening of foreign markets for EU investors in return for treaty commitments that give foreign investors access to the EU market” (ibid., p. 4). Hence, legal contradictions can exist, born out of political calculations. Applied to the case at hand, that would mean that the EC did not actually see both as a contradiction but rather a way to strengthen their hand in the CAI negotiations, to extract apparently satisfactory concessions by China that led to the conclusion of the agreement.

The political science literature considers the geopolitical aspects of the Sino-European relationship, the intentions behind policy tools like the screening mechanism and the prospects of cooperation or competition, including the politicization of trade and investment enabled in part by the 2009 Treaty of Lisbon (Meunier & Nicolaidis, 2019; González & Verón, 2019; Poletti & De Bièvre, 2014; De Bièvre et al., 2020; Young, 2019; Hooijmaaijers, 2019).

Among the political scientists there are those who are focused on European integration and the extension of supranational authority over trade and external relations (Meunier, 2014; Nieman & Bretherton, 2013; De Ville & Orbie, 2014; Bossuyt et al., 2018; Farnell & Irwin, 2012). There are also political economists who highlight the importance of the interconnectedness of the global economy and the structural changes (for example the rise of global value chains) that influence policy-making (Eckhardt & Poletti, 2016; Dür et al., 2020; Eckhardt & Lee, 2018, Dür & Baccini, 2018). The political science literature that has been reviewed also displays an interest into societal actors such as interest groups, NGOs and businesses and their influence on trade/investment policy-making (Cremoma, 2017; Dür, 2007; Laursen & Roederer-Rynning, 2017). However, not enough research has been conducted on the strength of the EC with regards to being a rule-maker in global investment or the degree to which the interests of the Union outweigh the interests of individual powerful member states. Investment is not evenly distributed among EU member states, which creates divergent interests, it is currently unclear to what extent these influence the common commercial policy. So far, a lot of the existing research has focused solely on policy analysis or hypothesizing about the future of European integration or Sino-European relations (Hooijmaaijers, 2019; Meunier & Morin, 2017; Farnell & Irwin, 2012). What is missing is a theoretical perspective that takes a systemic view of European policy approaches vis-à-vis China. Moreover, most of the political science contributions refrain from a comprehensive theoretical framework (with one exception), but primarily utilize broad concepts as tools to analyse the politics of investment and trade treaties. Meunier (2019) utilized theories about European integration such as liberal intergovernmentalism, neo-functionalism and historical institutionalism to explain the expansion of EU competence over FDI. Theories of European integration have proven to be of great utility with regards to explaining intra-EU developments, but lack explanatory power as it relates to external relations. The theories focus exclusively on the processes of European integration and dynamics of intra-EU negotiations. Studies employing such theories are very important but not useful for this case. Here, the question is regarding the process of the successful conclusion of the first standalone investment agreement by the EU, and the roles of internal *and* external actors.

In conclusion, the trade theories detail the determinants of FDI and its evolution, while European integration theories focus on the acquisition of competencies. Instead I will adopt IR/IPE theories to understand the underlying dynamics of the phenomenon at hand. I will contrast neo-mercantilism and liberal institutionalism, to shed light on the explanandum from

diverse angles. Despite clear differences in the way the two view the world, there are similarities in the ontology and epistemology. Both see the international system as anarchic, both see the capitalist system as a given and both theories have explanatory and prescriptive elements. Neo-mercantilism and liberal institutionalism were not featured in the relevant literature, however there have been applications in the past. Neo-mercantilism can actually be said to have a third incarnation in political science as well; a descriptive strategy of a state. Neo-mercantilism has been utilized sparingly by political scientists to assess European policy-making, and mostly in relation to the Common Agricultural Policy (CAP) (Potter & Tilzey, 2005; Raza, 2007; Chiuba Okeke, Cilliers & Schoeman, 2018). Van Apeldoorn (2002) contrasted neo-mercantilism and neo-liberalism in the diverging visions for European integration expressed on the European Roundtable for Industrialists (ERT) from 1983 to 1992. The ERT eventually moved towards a concerted undisputed neo-liberal consensus (referred to as 'embedded neo-liberalism') according to van Apeldoorn. Wigell (2016) uses neo-mercantilism and neo-liberalism as ideal types in his typology of regional powers' geo-economic strategies. Wigell conceptualizes both strategies as using economic power as a goal in itself, while diverging in terms of competition versus cooperation. Lastly, Lucarelli (2011) identifies Germany's economic policies as neo-mercantilist, seeking through competitive disinflation and wage repression to maintain its trade surplus, to the eventual detriment of Southern-European states. Liberal institutionalism as a prescriptive theory has been aligned closely with the European and American guiding philosophies of trade liberalization from the past decades.

Nevertheless, we are concerned here with the explanatory nature of neo-mercantilism and liberal institutionalism, how they view the contradictory policies of pursuing a treaty that liberalizes investment while – *inter alia* – implementing an FDI screening mechanism. Neo-mercantilism takes a state-centered view of the world, noting that the actions of states are inspired by their concern for their relative power position in the international system. Therefore, the contradictory move would be seen by neo-mercantilism as a rational decision of the EU to simultaneously protect its domestic interests while seeking access to an external market, to gain a first-mover advantage. Liberal institutionalism also considers the state the central actor in the international system, but is also concerned with international institutions and regimes. As such, the structure of the international system is comprised of more than states which enables and constrains their autonomy and strategic choices (Oatley, 2019).

The novel approach of contrasting these two theories will make a significant contribution to the growing literature on the EU's strategies in trade and investment to affect

the world around them, especially under this new ‘geopolitical’ commission (Nicolaidis & Meunier, 2019; Gstöhl, 2020; European Commission 2019). The research expands the scientific view about the EU’s perception of its own interests and influence regarding inbound and outbound FDI as well as the global investment regime as a whole. It sheds light on how the importance of material and ideational factors, as well as immediate (economic) and prospective (institutional) gains, weigh against each other in treaty negotiations. Furthermore, it will use the first investment treaty more than ten years after the Lisbon Treaty as a unique test case to investigate to what extent the EU has become a unitary actor in regulating FDI. The thesis investigates the extent to which Union interests dominated in the final phase of negotiations, as opposed to sectoral business interests which had the biggest stake. Additionally, it examines whether the EC was able to leverage the dependence on the EP’s consensus in negotiations with China as a ‘tied hands’ strategy, similar to national politics. This thesis will use a systematic approach, supported by a contrasting theoretical framework to make a first step towards enriching the EU-China political economic literature in light of the CAI, doubtlessly it will contribute to a growing body of work.

For society at large, the research will enlighten the common understanding of the dynamics that have led to the conclusion of the CAI between the EU and China. It traces the ‘how’, ‘when’ and ‘why’ EU-China relations soured early 2019 and yet managed to reconcile their differences in a tense political environment. However, merely three months after concluding the agreement the EP signalled it was unwilling to consider its ratification (Europarl, 2021a). On 4 May 2021, just ten weeks after the text was published, Trade Commissioner Dombrovkis declared that the Commission had suspended efforts to ratify the agreement (Dombrovkis, 2021b). Relations with China have clearly hit a new low, however, the issues at the heart of the disagreement are hardly new, politicians and civil society have spoken out about them for years. Therefore, it is even more interesting and relevant to consider the decision-making surrounding the EU’s first standalone investment agreement and trace the events through opposing theoretical looking glasses.

The thesis is structured as follows: in the second chapter the theoretical framework will be discussed, outlining neo-mercantilism and liberal institutionalism and formulating hypotheses connected to the phenomenon. The third chapter focuses on the methodology, consisting of process-tracing and document analysis, and the operationalization of the theoretical concepts. The fourth chapter entails the empirical analysis wherein the dependent variable shall be explored in greater depth and the sequence of events leading up to the CAI is

evaluated. The fifth chapter then lays out each theory's explanatory narrative and tests it on the basis of the empirical record. The conclusion will contain a summary of findings, discuss the strength and weakness of this research and suggest future avenues for research regarding EU and China's investment policies.

Chapter 2. Theoretical framework

This chapter focuses on the theoretical foundations used for answering the central research question. The first section looks into the origins and assumptions of neo-mercantilism, rooted in the oldest ideas around international trade. Then, the second section examines liberal institutionalism and the role of society and businesses in influencing economic policies and international trade and investment agreements. Although the two theories vary greatly in their ontology, both neo-mercantilists and liberal institutionalists take the capitalist system as a given, agree that the international system is anarchic and provide a systemic analysis in which “the behaviour of states, *as well as of other actors*, is strongly affected by the constraints and incentives provided by the international environment” (emphasis only applies to liberal institutionalism) (Keohane, 1984, p. 6). Both theories, despite being fairly comprehensive, still need some modifications to make them applicable to the case at hand and answer the central research question.

Neo-Mercantilism

Neo-mercantilism has its roots in mercantilism, which is regarded as the first economic school of thought. Mercantilism arose in the late 16th century Europe as capitalism replaced the old feudal order and national policies replaced municipal policies (Heckscher, 1935). The first theorizing and application of mercantilist ideas occurred in the Italian trading hubs of Venice, Genoa and Pisa. Antonia Serra is credited as the first mercantilist theorist (1613) (ibid.). Later, the Englishmen Thomas Mun (1571-1641) and Edward Misselden (1609-1654) wrote treatises about mercantilism in the new context of global trade by the British East India Company, which popularized it as mainstream economic theory and practice throughout 17th century Europe (Magnusson, 1993). The trade balance became the primary concern of scholars and statesmen, instead of micro-level concerns like the morality of distribution, usury and corrupt bankers (ibid.). Mercantilists were the first to use a principled framework approach to analyse and prescribe economic policies with the state at the center (ibid.). Mercantilism is often chastised for supposedly promoting the hoarding of gold, however, mercantilists actually considered strengthening the domestic production base as critically important. High production would facilitate exports and restrictions on finished goods would improve the balance of payments (Perrotta, 1993). Mercantilists like Mun, Misselden, Serra, Jean Bodin and Philip Wilhelm von Hornick dominated proto-economics. Mercantilism was eventually dealt a fatal blow by the English liberal economists like David Hume (1752), Adam Smith (1776) and David Ricardo

(1817), with ideas of absolute/comparative advantage and brought liberalization of trade into the mainstream (Kirshner, 2009).

Neo-mercantilism rose to prominence during the 19th century as an alternative to the liberal free trade model particularly for developing (industrializing) economies. ‘Neo’ indicated a paradigm shift from military and imperialist aims, towards viewing economic development as a goal in itself (Okeke et al., 2018). Alexander Hamilton (1755-1804) was instrumental in the shift and renewed interest in (neo-)mercantilism. Hamilton wrote the *‘Report on Manufactures’* (1791) which was to be the foundation of the American School of economics whose ideas guided American industrialization and made it the largest economy in the world (Lind, 1997). The United States with Hamilton as first Secretary of the Treasury focused on creating a solid financial and physical infrastructure to spur domestic development while protecting it from superior foreign firms (ibid.; Clay, 1851). Friedrich List (1789-1846) wrote *‘Das Nationale System der Politischen Ökonomie’* (1841) and with it created a theory of national economics instead of economics focused on individuals like Smith’s. Although List also believed that free trade suited a mature economy like Great-Britain best, long-term development for developing economies could only succeed by nurturing agricultural and particularly industrial protection (Koot, 1993). List built upon Hamilton’s argument for infant industry protection. Unlike classical mercantilists, List advocated only targeted and temporary protection of industries. Of particular importance to the case at hand is List’s criticism of Smith that he “seeks almost entirely to exclude politics and the power of the State” (List, 1841, p. 182). The state is undoubtedly the central actor for neo-mercantilism. List profoundly inspired the German historical school of economics and the likes of Gustav Schmoller who stressed the importance of (neo-)mercantilism and state-building, stating: “the state community is formed into an economic entity at the same time, thus lending it enhanced significance” (Schmoller, 1884, p. 44-45). Thus, neo-mercantilists did not disagree with the fundamental critiques of Adam Smith regarding the workings of the market, they integrated advances in economic thought. However, neo-mercantilists took issue primarily with the politics of liberalism, inserting instead realist assumptions (Kirshner, 2009).

The ideas of List and Hamilton have carried on in current-day economic debates and practices. Since World War II countries have successfully and unsuccessfully employed certain neo-mercantilist policies in order to develop their economies. Even industrialized states like the United Kingdom and the United States have veered to such neo-mercantile policies whenever their economic supremacy was in doubt, during the 1920s and 1930s or the 1970s (Kirshner,

2009). Stephen Krasner wrote '*Defending the National Interest: Raw Materials Investment and American Foreign Policy*' in 1978, which was considered a seminal work on American foreign policy meshed with neo-mercantile economic thinking, such comprehensive writing has not been conducted regarding the EU. A critique of neo-mercantilism is that it is often hard to distinguish the policy prescriptions from economic theory, which leads one to question whether it is a description of an economic policy or a theoretical framework through which to view the world economy.

However, we can certainly deduce clear assumptions from the school of neo-mercantilism. As the International Political Economy (IPE) variant of realism, the two theories carry a lot of similarities. Robert Gilpin in his book *US Power and the Multinational Corporation* (1975) describes the focus of neo-mercantilism as "the priority of national economic and political objectives over considerations of global economic efficiency", whereby global efficiency refers to free trade (Hettne, 1993, p. 237). Oatley (2019, p. 33) identifies the three main propositions of neo-mercantilism: first, economic strength is a critical component of national power; second, trade is to be valued for exports, but governments should discourage imports whenever possible; and third, some forms of economic activity are more valuable than others. Manufacturing is superior to agricultural output and high-technology industries are superior to mature industries like steel. The state plays an active role in the economy in order to promote valuable economic activity that furthers the nation's interest, which is different from any individual interest. That means that the state is engaged in resource allocation. Neo-mercantilists pay attention to the consequences of the distribution of income within and between countries resulting from the processes of resource allocation (Oatley, 2019). This explains the neo-mercantile (and realist) insistence on relative gains as opposed to absolute gains. Mercantilists first introduced the notion of the 'zero-sum game' in international economic relations, since not every country could obtain a positive trade balance (Cohn, 2016). Relative gains were therefore most important, which determined your relative power position in the anarchic international system (Kirshner, 2009). States are seen as the only autonomous actors in the international system, organizations like the International Monetary Fund (IMF) and World Trade Organization (WTO) are merely arenas for interstate competition, not actors in themselves, nor facilitators of cooperation. As the 'zero-sum game' already illustrated, neo-mercantilists do not consider cooperation to be easily achieved, much less maintained. Every state pursues its self-interest in a self-help system. Even if there is mutual benefit, cooperation will have both states concerned about the distribution of gains and fearful of how the other will

utilize their increased capabilities (Waltz, 1979, p. 105). Hence, even a successful cooperation is based on mutual insecurity. Furthermore, states are wary of too much cooperation out of fear it makes them dependent on each other. Neo-mercantilists connote interdependence with mutual vulnerability and therefore distrust only grows, which explains why they see successful interstate relationships as based on coercion (Waltz, 1979). Principal-agent theory neatly suits economic relations between states, both rely on each other to implement trade and investment treaties within their borders but have different interests and are often subject to an information asymmetry. Considering that neo-mercantilism values power over international law, both are at each other's mercy, which is why retaliation is essential in order to prevent shirking. Shirking occurs when one side chooses not to comply with the agreed upon stipulations.

For neo-mercantilists, politics and economics are inextricably linked, “no economic system can exist without a political framework” and so they can only be analysed in conjunction (Hettne, 1993, p. 240). They believe in the importance of the market, but it is ultimately subordinate to the national interest. This manifests itself through (non-)tariff barriers against foreign companies, discouragement of consumption of imports, currency manipulations and limiting foreign ownership of domestic firms (Cwik, 2011). States undertake these actions to increase domestic productivity, competitiveness and capital while exploiting export markets (Okeke et al., 2018). Different economic models can exist in the world and although globalization has constraining and enabling effects, they do not believe that state power is fundamentally undermined by it (Cohn, 2016). Hettne (1993) sees in the drive towards regionalism and regional economic blocs, a key characteristic of neo-mercantilism. The idea is that a regionalized world system is more stable and durable under anarchy, while providing the benefits of production specialization and economies of scale. A neo-mercantilists view of European integration conceives of it as a political project to build a strong internal market as a fortress against foreign competition, and to increase competitiveness through economies of scale and scope (van Apeldoorn, 2002).

Neo-mercantilists like List and Hamilton have argued – contrary to classical economists – that protectionism and openness can exist simultaneously and benefit vulnerable, nascent or strategic industries that are critical to the national interest. States can act multilaterally and unilaterally depending on the context. Raza (2007) uses a neo-mercantile perspective to differentiate between offensive interest and defensive interests in EU trade policies. For sectors of offensive interests, the EU has sought market access, non-discriminatory treatment for EU companies and reductions of regulatory commitments. Concurrently, defensive interests are

located in less competitive sectors and thus seek protection from the EU, as is the case for the agricultural sector. Altogether, after reviewing the neo-mercantilist theory, the following hypotheses have been deduced:

H1: *The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is for the purpose of maintaining its relative competitive position vis-à-vis the contractual state in the international economic system*

H2: *The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is to ensure a first-mover advantage vis-à-vis its competitors*

H3: *The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is to facilitate contradicting interests rooted in heterogeneous competitiveness vis-à-vis counterparts in the contractual state*

H4: *The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is in order to pre-empt potential shirking behaviour of the contractual state by encapsulating it into an investment regime*

Liberal institutionalism

Liberal institutionalism is the dominant theory in IPE and much like neo-mercantilism it has clear explanatory and prescriptive elements to it. The prescriptive nature of the theory is mostly related to how cooperation can be achieved and its advocacy for free trade, which has dominated international trade relations since the end of World War II. The origins of liberal institutionalism can be traced back to Adam Smith's magnum opus; '*The Wealth of Nations*' (1776), in which he strongly criticized mercantilism and its tenets laid out by Mun and Misselden and quickly became the dominant economic doctrine in Britain. Smith ascertained that it was not precious metals and a trade surplus that created wealth, but productivity through the division of labour under conditions of competition and rational self-interest. Another key figure in liberal economic thought was David Ricardo, whose seminal work '*On the Principles of Political Economy and Taxation*' (1817) laid out the theory of comparative advantage which determined that free trade could be profitable for everyone if each country focused its production on those goods that they could produce at a lower price relative to other countries. That country would export those products while importing the goods where it does not have a

comparative advantage. It is a model of free trade based on differences in factor endowments or technological progress (Maneschi, 1998).

Immanuel Kant (1724-1804) was a founding figure in liberal philosophy and described by Russett as the first liberal institutionalist (2013, p. 95). Kant adds three constraints on state behaviour to the realist constraints (power ratio, allies and distance). Two of note are: trade interdependence which incentivizes states to maintain peaceful relations; and international organizations that constrain policy-makers through the promotion of peace and free trade (Russett, 2013, p. 100-101). The core of liberal institutionalism is clearly summarized by Kant, stating; “sustained commercial interaction becomes a medium of communication whereby information about needs and preferences are exchanged, across a broad range of matters ranging well beyond the specific commercial exchange. This may result in greater mutual understanding, empathy, and mutual identity across boundaries” (p. 102). The Kantian constraints demonstrate how liberal institutionalists see the evolution of international economic relations as a positive feedback loop that generates structural forces of interdependence and enables domestic actors in ways that constrain the autonomy of the state. Liberalism evolved over time, but just as mercantilism was both theory and practice in 17th century Europe, so liberalism was in Great Britain after the repeal of the Corn Laws (1846) until the Great Depression (Howe, 1998). John Maynard Keynes (1883-1946), as the most influential economist of the 20th century, revitalized liberalism for the post-war era of embedded liberalism (Ruggie, 1983). As leading monetary theorist and Britain’s chief negotiator at Bretton Woods, Keynes played an important role in enlarging the role of the state in the management of market forces and the founding of institutions like the IMF and the World Bank (Cohn, 2016).

In the 1970s and 1980s, as the world turned to orthodox liberalism, the school of liberal institutionalism emerged in IR and IPE, with Robert Keohane (1984) as its leading figure. Other notable scholars include Joseph Nye Jr. (1973), Peter Katzenstein (1998) and Helen Milner (1997). Liberal institutionalists see international institutions like the IMF, WTO and World Bank as helpful supplements, in order to mitigate market failure and collective action problems (conflicting interests, lack of enforcement, lack of transparency) in international relations. Institutions generate efficiency and are assumed to be politically neutral. By acting as an intermediary force in the international system, institutions can facilitate mutually beneficial economic interactions. Hence, liberal institutionalists emphasize absolute gains instead of relative gains, a positive-sum game where everybody can win. As such, liberalism is less

concerned with distributional consequences compared to neo-mercantilism and distinguishes less between more or less powerful/rich states (Cohn, 2016).

Thus, the essence of liberal institutionalism is that, contrary to neo-mercantilists, liberal institutionalists consider institutions and regimes as helpful in ameliorating the conditions for cooperation. Cooperation is possible in inter-state relations despite the problems that frequently inhibit it in an anarchic international system. Problems such as distrust, lack of information, cheating and free-riding, but there are ways for states to transcend these problems. Collective benefits, absolute gains or the 'shadow of the future' (prospective gains) are incentives for states to successfully cooperate (Sterling-Folker, 2013). This is also where institutions play a crucial role to facilitate cooperation, both formal institutions such as the United Nations (UN) and informal institutions or regimes which are "sets of implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge" (Krasner, 1983, p. 2). Critical to the necessity of institutions is the liberal conception of the state as not fully rational, but instead marked by 'bounded rationality'. Hence, states resort to satisficing, instead of maximizing, which is impossible in the complex world we confront with limited capabilities and knowledge (Keohane, 1984).

It is important to note that for Keohane cooperation does not connote a simple alignment of interests, but rather 'mutual adjustment', which requires negotiation to bring policies into conformity (p. 12). If states do not try to adjust, there is discord, while if states automatically facilitate each other's goals through their policies, there is harmony and no need for cooperation (p. 51). International cooperation is an iterative process, states learn from each other's positions and can be socialized into cooperation, creating a positive feedback loop that expands cooperation into new issue-areas. Institutions are believed to facilitate cooperation and provide the rules and principles that reduce decision-making costs. Institutions can collect information on the policies of actors and punish them, either materially or through naming-and-shaming (Keohane, 1984). A crucial concept related to cooperation is interdependence. Keynesian economists would also concur that interdependence improves coordination and harmonization of macroeconomic policies, which are beneficial to all (Keohane, 1984, p. 11). Liberal institutionalists view interdependence positively, since mutual dependence reduces the likelihood of conflict and optimize the necessary conditions for peace or liberalization. The state loses some of its autonomy due to the constraints placed upon it by conditions of interdependence.

Liberals traditionally view politics and economics as two autonomous spheres. Economics is for the benefit of individuals, not to increase the power of the state (Oatley, 2019). For neo-mercantilists the world political economy revolves around “the pursuit of wealth and the pursuit of power” (Gilpin, 1975, p. 43), which are mutually reinforcing and the aims of national policies. Keohane states instead that the world political economy actually revolves around trade-offs, particularly between the “long-term power/wealth interests of the state and the partial interests of individual merchants, workers, or manufacturers on the one hand or short-term interests of the society on the other” (1984, p. 23). Domestic interactions also play an important role in liberal institutionalism, states are influenced and pressured by societal interests. Interdependence does not only exist among states, but also within states (Gourevitch, 1978).

Scholars like Stefan Schirm and Milner have added to the conceptualization of domestic interests shaping international decision-making and buffering the effects of internationalization (Milner & Keohane, 1996). The struggle among societal interests with regards to trade policy preferences is between those in favour of protectionism and those in favour of liberalization. Multinational corporations (MNCs) play a large role, but so do coalitions of small firms, associations or NGOs. Schirm (2020) notes that international institutions “strengthen, undermine, or transform the ideas and interests of domestic groups and by extension influence governmental preferences” (p. 401). As states participate according to the rules and norms of an existing regime, their behaviour is constrained but not homogenously. Certain states may accept a regime because it can constrain a rival state with greater capacities, while compliance is not costly for them because the regime already aligns with their intentions. The following hypotheses have been deduced from liberal institutionalism:

H1: The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is to ensure future cooperation and mutual benefit through a positive feedback loop

H2: The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is because of expected long-term benefits outweighing costs in the form of access to information, ameliorating collective action problems and shadow of the future benefits

H3: The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is for the purpose of maintaining consistency with previous bilateral investment treaties of its member states

H4: The choice for an offensive investment strategy in addition to a defensive strategy by an emerging state apparatus is a reflection of the perceived necessity to maintain the credibility of the investment system for third parties

In conclusion, neo-mercantilists explain the behaviour of states (or an emerging state apparatus) based on its position in the international system, whereas liberal institutionalists look at the problems and remedies to ensure cooperation under anarchy. For neo-mercantilists, states are in constant competition with one another, “bellum omnium contra omnes”¹ in Hobbes’ state of nature, as the international system is without a central government. Thus, wealth is important for the accumulation of power and power will enrich the state. The state will seek to liberalize trade and investment in sectors where the domestic industry is strong and competitive, in order to expand operations and acquire more wealth. Meanwhile the state will seek to protect those industries that are vulnerable and weak, in order to strengthen them and oftentimes also protect national security. Liberal institutionalists see more depth in the policy formulation stages of a state, its various domestic actors and the global institutional and legal context. Although anarchy rules, cooperation is feasible and institutions can fill the void of anarchy (Sterling-Folker, 2013, p. 117). Collective action problems that stand in the way of international economic cooperation can be effectively eliminated through institutions and mutual adjustment. In summary, the first neo-mercantilist hypothesis looks at defensive interests of the EU, the second at offensive interests, the third at each’s relative competitiveness which result in different needs and the fourth at a coercive pre-emptive action in a principle-agent dilemma under mutual dependence. As for liberal institutionalism, the first hypothesis focuses on the mutual benefits through mutual adjustment which incentivizes spill-over to other issue-areas. The second hypothesis looks at the benefits for the EU alone, the third at the maintenance of consistency with its prior legal obligations with China and the fourth at the maintenance of consistency and credibility for the rest of the world.

¹ “the war of all against all” (Hobbes, 1647, p. 5)

Chapter 3. Methodology

In this chapter we will look at the methods that are employed to conduct the research related to the main question and test the hypotheses. The thesis utilizes a qualitative approach, which is uniquely suited to assemble the empirical material in support of the explanation for the outcome of the case, namely the successful conclusion of the CAI. Process-tracing is the specific method used in the empirical research that will open up the black box of causality between ‘input’ and ‘output’. The choices made with regards to the methodology will be explained, as well as the intricacies of process-tracing. Lastly, the theoretical constructs derived from neo-mercantilism and liberal institutionalism will be clarified and operationalized.

Process-tracing

Qualitative research is essential for the case at hand since it allows for open-ended case-specific insight into actor motivations, which are at the core of the central research question. Process-tracing is becoming more and more popular, especially in the social sciences. It has shown itself to be the most effective research method in terms of uncovering processes in political science, particularly processes of decision-making and ideational proliferation. Central to process-tracing is revealing causality and disentangle the agents and their interests, as well as institutional features diachronically. The presence of certain factors (or independent variables) has consequences that lead to the dependent variable: the simultaneous choice of an offensive and defensive investment strategy. Process-tracing is employed in tandem with document analysis and data triangulation. Triangulation involves investigating various viewpoints, separated in time, space and source, in order to corroborate findings and eliminate biases which lend the research more credibility (Bowen, 2009; Carter, 2014). Document analysis helps with systematically approaching primary and secondary sources for the qualitative analysis, it entails an iterative gathering, review and interpretation of data (Gross, 2018). Through document analysis we recognize that “all documents exist within the context of their creation” which makes us mindful regarding their representation (ibid., p. 2). The research started with a preliminary search for potential sources; certain keywords, databases and platforms that provide relevant material. Then, the documents were sampled and stored, a process of several weeks, based on an expressed relation to EU-China trade and investment. Next, important passages were highlighted, the documents were coded and categorized according to their importance, source and subject matter. Then, each document was interpreted and re-interpreted based on an

accumulative perspective after analysing all documents. The fourth and fifth chapters thus reflect the final analysis of all sources.

Bennett & Checkel (2015) state that a justifiable decision when to start process-tracing is at a critical juncture, when the actor chose a specific course of action. The appropriate critical juncture considering the dependent variable would be 13 September, 2017, when the EC proposed the creation of an EU-wide FDI screening mechanism, which is widely considered to have Chinese SOEs as its main target (Hooijmaaijers, 2019; Wu, 2020; de Jong & Zwartkruis, 2020). The choice of an offensive investment strategy and to conclude the CAI with China runs counter to its simultaneously expanding defensive efforts. However, if we neglect the process leading up to that time, including the start of negotiations and the changing EU posture vis-à-vis China, we would risk omitting essential information. Therefore, the research harkens back a decade before that critical juncture, to 2007, when the negotiations for a Partnership and Cooperation Agreement (PCA) began, which included investment provisions. The PCA negotiations failed but it is an important event in the lead up to the CAI negotiations. After September 2017 process tracing intensifies to also take into account every relevant European Council and Council of the EU meeting until 2021. By tracing the events in the final years of the treaty negotiations we can create a narrative and assess which hypothesis and theory is supported by the empirical evidence and which can be rejected.

There are three types of process-tracing: theory-building, theory-testing and explaining outcomes. Generally, the first utilizes an inductive approach, the second an deductive approach and the third an abductive approach (Beach & Pedersen, 2013). Firstly, theory-building is not the purpose of this thesis, there is a finite amount of time available to the researcher and no theorized causal mechanisms will be built from the ground up. Instead, the thesis utilizes well-worn IR/IPE theories to explain a phenomenon or policy outcome, which has been characterized in previous chapters as counter-intuitive given the EU-China relationship and global dynamics. The question then becomes whether a theory-testing or explaining-outcomes approach is more suitable. Theory-testing places the theories at the centre, while explaining-outcomes starts from the case itself. Theory-testing also tends to utilize theories that can provide well-specified causal mechanisms for a granular process, to see whether the mechanism is present or not. Explaining-outcomes process-tracing relies on abductive reasoning and aims to provide a minimally sufficient explanation for the outcome. The abductive approach entails going back and forward from theory to reality, by conceptualizing neo-mercantilism and liberal institutionalism as potential mechanisms for which tests are developed and evaluated against the empirical record.

Abductive reasoning is used in like situations where the premise is clear; the CAI was concluded, but the conclusion; the driving forces, are not evident and only probable. There is only the information which is available that one can use to make logical inferences and provide a probable explanation (Reichert, 2010). We can state that in explaining-outcomes the theory serves primarily as a guide to our expectations about the case, instead of having the case be a guide to how theory manifests in reality. Explaining-outcomes mainly assesses the utility of a theory in explaining the puzzling outcome.

In order to answer the central research question this thesis will put the case at the centre and employ explaining-outcomes process-tracing. From both theories, hypotheses have been deduced about the causes of the investment treaty and the motives of the relevant actors within the EU. This also involves looking at non-systemic mechanisms that are particular to the case instead of only systemic mechanisms. The thesis is not interested in merely uncovering how X led to Y, how intentions lead to a treaty, but why the EU pushed forward regardless of the changes in the political economy since 2013 and provide a minimally sufficient explanation. In that sense, the theoretical mechanisms and concepts deduced from neo-mercantilism and liberal institutionalism are heuristic instruments that help us reach the best possible explanation, which we can test (Jackson, 2011). The outcome would certainly not yield a single generalizable mechanism as is common for theory-testing, it is inherently difficult to generalize the complex context-specific conditions that enable the outcome. However, certain patterns of EU trade policy decision-making, and its relevant actors, may be generalizable beyond the CAI. The research will trace the developments of the CAI and locate them alongside the hypotheses to form an explanatory narrative. Process-tracing allows us to test and observe causality in the sequence of events, in that way preventing any hint of spuriousness that afflicts other research methods.

When presenting a final mechanism to explain the case the elements of the causal mechanism ought to be “insufficient but necessary part[s] of an unnecessary but sufficient [mechanism]” (Mackie, 1965). Hence, the factors that determined the outcome of the CAI are likely not enough in themselves, but together have a cumulative impact that led to the dependent variable. As is likely in the case of explaining-outcomes process-tracing, it can become necessary to combine and create an eclectic composite mechanism in order to best provide a sufficient explanation. Sil and Katzenstein (2010) call this ‘analytic eclecticism’, it is the meta-theoretical base of the research which is consistent with a mechanistic understanding of social reality. Analytic eclecticism distinguishes itself from paradigm-based thinking about

international politics, but also does not disregard theory entirely like the literature reviewed in the introduction. Parsons (2007) discusses four types of causal mechanisms, the one best suited to the theorization about the motivations of the EC for concluding the CAI is the ‘structural causal mechanism’. The structural causal mechanism is based on the interaction of policy preferences and an existing structure which create certain structural constraints and incentives (p. 65). To eventually achieve minimal sufficiency in explaining outcomes process-tracing is an iterative process, which is a reflection of the abductive reasoning.

An alternative to process-tracing for within-case analysis is the congruence method in which an independent variable is deduced from theory to test whether it can explain the outcome. Process-tracing is more comprehensive and reliable by going beyond testing correlations and instead trace the causal mechanism that connects the independent and dependent variables (Beach & Pedersen, 2013).

In order to empirically validate the theories and their respective hypothesis the thesis needs to critically assess the empirical evidence. Evidence in process-tracing is termed; causal-process observations (CPOs), to contrast with quantitative data-set observations (DSOs) (Collier, 2011). Whereas all data is considered equal, CPOs are unique and as such vary in terms of importance. However, observations in the social sciences cannot be accepted as evidence by itself, they need to be assessed rigorously, through data triangulation where possible. The question remains however, how to assess the uncovered evidence or CPOs. There are various types of inferential logics to assess the evidence and its consequences. The Bayesian Logic is most fitting in process-tracing research, which many qualitative researchers have recommended (Beach & Pedersen, 2013; Bennett & Checkel, 2015; George & Bennett, 2005). Bayesianism helps identify the probative value of a CPO relative to the competing theories. Central is the idea that not all evidence is equal, its value depends on whether a hypothesis uniquely predicts the evidence to exist or does so certainly (Bennet & Checkel, 2015). Where certainty has disconfirmatory power since it is *necessary* to support our hypotheses, uniqueness has confirmatory power for the evidence is *sufficient* to support our claims. When coding and assessing the collected CPOs there has been due consideration for the nature of the evidence; to which hypothesis it pertains and whether it necessary to support the hypothesis or sufficient. In the end a sufficient explanation will entail the least possible number of variables to explain the conclusion of the CAI, based on the supported theory and their respective hypotheses. Once again, there are clearly subjective judgments made in assessing evidence and confidence, what matters is that the research attempts to do it as transparently as possible.

Process-tracing is criticized for the difficulty it has with substantiating the causal mechanism as well as the danger of infinite regress, which entails an endless quest for the cause of every minor action or cognition. Such as trying to lower the level of explanation from the EU to the member states and eventually domestic politics. This process could not be infinite however due to the competencies required, but since the research focuses on the ‘emerging state apparatus’ meaning the EU, it will restrict its analysis to the actions of the EC, European Parliament and the European Council. These institutions can be influenced by businesses and member states alike, although they are different in power and influence, neither has competency over EU common commercial policy. That way, infinite regress is impossible and process-tracing will give sufficient insight into the causal mechanism that led to the conclusion of the CAI.

Operationalization

The independent variables deduced from neo-mercantilism and liberal institutionalism utilized in the hypotheses are operationalized below. Firstly, the ‘emerging state apparatus’ refers to a state-structure in-the-making, meaning that the EU is treated here as a federal state-like unit. It is comprised of the executive body, the EC, which has been in charge of negotiating the CAI through the DG Trade. The Council of the European Union, acts as a senate judging the proposals of the EC, once approved by the European Parliament. The Council of the EU is composed of 27 national ministers (depending on the issue-area) and has a rotating six-month presidency held by a national government. Lastly, the European Parliament (EP) is the directly-elected legislative body of the EU which is tasked with approving or rejecting international treaties negotiated by the EU (per article 218 TFEU), called the consent procedure. The EP cannot amend any agreement, relevant committees are updated on the progress of treaty negotiations. From now on, when the hypotheses refer to declarations through statements, speeches or documents by EU politicians, it is a reference to – inter alia – declarations by President Ursula von der Leyen or Charles Michel, Trade Commissioner Valdis Dombrovskis or his predecessors, the Director-General of DG Trade, the EU Chief Negotiator, as well as communications from the President of the Council of the EU, chairpersons of the EP’s International Trade (INTA) committee and the Delegation for Relations with the People's Republic of China (D-CN). Other more general documents are also examined, such as press releases, strategy reports, departmental reviews, post-summit communiqués, Council reports, resolutions by the EP and question and answers between the EP and the EC.

The first hypothesis derived from neo-mercantilism refers to the changing ‘relative competitive position’ of the EU vis-à-vis China. To find the empirical manifestation of this neo-mercantilist concept one considers the importance of the EU versus China in the global economy through metrics such as GDP, contribution to global trade and economic leverage vis-à-vis each other in terms of critical inputs and high value-added industries. Finding such evidence is necessary, what would not be necessary but sufficient is finding declarations, official documents, and/or statements from the EU institutions and/or its leading politicians that justify the CAI in terms of defending its relative competitive position opposite China. The CAI needs to provide for the conditions in which the EU can stay the decline of its competitiveness.

The second hypothesis highlights the expected desire by the EU to want to obtain a ‘first-mover advantage’ in China with regards to investment protection and access vis-à-vis competitors in the global economy. States that can be classified as economic competitors are the top trade partners of China; the United States, Japan, South-Korea, Australia, Brazil and the Association of Southeast Asian Nations (ASEAN) (OEC, 2020). These states (or emerging state apparatus) cannot already have investment treaties of a similar scope with China, meaning that the EU benefits from superior access and protection in the Chinese economy. Additionally, at least some of the benefits accrued by the EU owing to the CAI must be exclusive and not on an MFN basis. EU politicians would reference the level of protection and access of other states, while pressing for progress in order to stay ahead of economic competitors.

Examining the third hypothesis requires insight into the heterogeneous competitiveness of European industries vis-à-vis Chinese competitors and their expressed desires for offensive and defensive measures depending on their competitiveness. This means that the CAI needs to improve upon the position of European businesses in China, that have a competitive edge over Chinese competitors. Meanwhile, the trade defence instruments need to be aimed specifically at tackling large Chinese competitors in the Single Market. An admission from the relevant actors inside the EU, that their actions have been aimed at protecting vulnerable domestic interests and/or expressing a desire to create opportunities for sectors where China is dependent on the EU, would be clear evidence in support of the hypothesis.

Lastly, the fourth hypothesis refers to the CAI as a coercive mechanism to prevent shirking, meaning a potential failure on the part of China to live up to promises of market access and investment protection. The treaty would have to contain dispute settlement mechanisms that allow the EU to enforce areas where previous WTO arrangements failed. Furthermore, through statements and other communications the EU, and in particular the EC and DG Trade,

must have made clear that the necessity for the CAI is at least in part due to mistrust from the EU that China would otherwise treat EU interests unfairly. For example, a perception among EU officials that China would roll back existing market access.

For the first hypothesis of liberal institutionalism the CAI needs to be established as a vehicle that facilitates continuous dialogue and cooperation beyond the rules it establishes in terms of investment. A positive feedback loop would imply that from the successful conclusion of an investment treaty mutual trust could be nourished that leads to further cooperation and spill-over in other issue-areas. If the research finds that the CAI has built-in avenues for future cooperation and information-sharing, that already constitutes a limited forum for mutual adjustment and cooperation. Furthermore, EU politicians would be expected to praise the immaterial value of the CAI for pragmatic cooperation between China and the EU. An agenda shared by both sides that indicates further milestones such as an FTA or other cooperation agreement would also constitute evidence of a positive feedback loop dynamic.

The second hypothesis expects the choice for an offensive investment strategy to be explained by the prospective gains for the EU and by seeing the CAI as a mechanism to alleviate collective action problems generated by a lack of information, surveillance problems and enforcement. The treaty would need to clearly and concisely address the issues and allow for communication on the progress of implementation. The EU officials should also express their support for the treaty in terms of future benefits the EU will accrue from the benefits of the treaty to its outbound FDI, as well as measures to influence the implementation and safeguarding of investor rights in China. For this, one would expect to find the evidence in speeches made by the Trade Commissioner, officials from DG trade and/or chairpersons of relevant EP committees.

The third hypothesis refers to maintaining consistency with previous BITs from individual member states with China. For this hypothesis not to be rejected it would be necessary to find consistency in European BITs with the new CAI and attention to those BITs by the EC. This means that the CAI cannot negatively contradict the protection standards that are already in place, however they can expand those in line with more recent BITs concluded by China. The proof is in the pudding, the text of the CAI will reveal whether it supersedes existing BITs or not. Moreover, if EU officials actively voice their consideration for previous agreements in inter-institutional documents – for example between the EC and EP – that would constitute clear evidence in support of the hypothesis.

The last hypothesis refers to maintaining credibility of the existing liberal investment regime that has been the foundation of European economic policy. The treaty would thus be conceived of as a signalling instrument to third parties, especially developing countries. BITs have come under increasing scrutiny because they fail to take into account sustainable development and allow for an asymmetrical litigation game where multinationals can sue governments for responsible governance that hurts their bottom-line. Particularly developing countries are vulnerable for such practices, and therefore countries like Ecuador and Bolivia have abrogated all their BITs (Cervantes-Knox & Thomas, 2017). If the CAI is indeed conceived of as a signalling device by the EU, one would at least expect evidence that the EU takes ownership of the existing global investment regime. Furthermore the CAI would have to address the concerns around fairness of investment, sustainability and the reform efforts to the Investor-State Dispute Settlement (ISDS) system in a novel manner (Europarl, 2021b). Lastly, public declarations by EU politicians in the forms of speeches, documents or statements have to defend the CAI as a new standard or mould of investment treaties, acknowledging the gaps existing in the current system.

Document analysis

A variety of sources has been consulted, relying occasionally on triangulated legal and economic analyses (such as regarding the content of the agreement) of think tanks such as Bruegel, MERICS and CEPS. All available publications regarding the CAI across the selected time period by the EC, Council of the EU and EP have been analysed to get an insight in the changing strategy, demands and expectations. Furthermore, as a part of the process-tracing exercise a sequence of public events has been established based on official sources and statements by high-level actors in secondary media in order to identify critical junctures in the negotiations. When analysing public statements by EU politicians and officials it is important to recognize the inherent bias in the information being presented, since each has their own interests and hides, or emphasizes, information accordingly. The EC, due to its role in the institutional process as executive branch, needs to garner support for its actions. However, they are not equally dependent on support from the Council and the EP. The Council provided the mandate to negotiate the CAI in the first place, government leaders are closely involved and need to give unanimous consent to conclude the negotiations. The EC has to make sure that the final product will be in line with the changing dynamics and desires in the EP in order to convince them to consent. Whereas the European Council is generally more concerned with the

effects on member states and national interests, the Parliament tends to be equally – if not more – concerned with safeguarding European values. This means that it is to be expected that the Council takes a more pragmatic stance and the Parliament a more idealistic stance, the EC would try to oscillate in the way it promotes any agreement between those two perspectives. Document analysis guides the process of critically reviewing each source. Additionally, the research looked at the participants of the annual Civil Society Dialogues on the progress of CAI's negotiations to identify critical stakeholders, whose positions and interaction with national and supranational institutions have been analysed, to determine their impact.

Chapter 4. Empirical Analysis: tracing the CAI

In this chapter I will begin by detailing the content of the CAI as the EU's offensive investment strategy and the trade defence instruments as part of the EU's defensive investment strategy. Then, I will be providing context for how the CAI negotiations came about, gained speed years later and met their set deadline, while inserting theoretical concepts to explain the events.

Offensive investment strategy

The content of the CAI is based on three pillars: market access, level playing field and sustainable development. Starting with market access, the CAI provides EU businesses very little actually new liberalization, it mostly locks in unilateral Chinese liberalization under a binding treaty which provides certainty and avenues for enforcement (Dadush & Sapir, 2021). It should be noted that particularly access commitments are very asymmetrical, since the EU market has always been largely open to Chinese investors. There is a ratcheting clause in the agreement which ensures that future market openings by China are automatically extended to EU businesses (Weyand, 2021a; Chimits & Stec, 2021). Openings granted in the manufacturing sector are exclusively granted to EU businesses, although as stated earlier these include many commitments China had already made such as the 2018 decision to abolish joint venture (JV) requirements in the automotive sector (Shirouzu & Jourdan, 2018). Openings granted in the services sectors are on an MFN basis according to WTO rules and thus benefit all countries. China opens eight sectors previously closed under WTO schedules, partially opens eleven that were previously closed and most others that had been partially opened get their JV requirements scrapped (Dadush & Sapir, 2021).

A number of service sectors are of particular importance to the EU: financial services, healthcare, telecommunications, cloud services and air transport services (Dombrovkis, 2020; Weyand, 2021a). Healthcare and financial services require the most foreign investment project approvals of all sectors in China, while fixed and mobile telecoms are one of the most restricted areas for FDI in China (0.750) (OECD, 2021; Covington & Burling, 2015). China has removed JV requirements and foreign equity caps for banking, trading in securities and insurances (Annex 1 Entry 27, 31, 33 & 34). China has granted access to eight cities for private hospitals (Annex 1 Entry 18). EU firms were allowed access to Chinese telecommunications market with a shareholding percentage of maximum 49% (Annex 1 Entry 12). EU firms also cannot exceed a 50% shareholding percentage in datacentre services, online data processing and transaction

processing services (Annex 1 Entry 12). Now, in terms of manufacturing, by far the most important sector is automobiles. In 2020, the automotive sector companies accounted for 62.5% of all EU FDI in China, most of that coming from the German trio; Volkswagen, Daimler and BMW (Rhodium, 2021). Ownership caps (max 49.9% in JVs) were already announced in 2018 to be abolished by 2022, the CAI reaffirms that (Annex 1 Entry 6). However, China grants exclusive access to EU businesses in its new energy vehicle (NEV) market without any restrictions if the investments exceed \$1 billion (Annex X). China is the largest NEV market, accounting for 55% of global sales (Hu, 2021).

Level playing field was another big priority for the EU coming into the negotiations. After the CAI's conclusion it has been reiterated that the agreement 'rebalances' relations (Dombrovkis, 2021a; Weyand, 2021a). Four issues are important here: SOEs, transparency for subsidies, forced technology transfers and participation in standard setting. SOEs are comprehensively defined and apply to all government levels (Section II, Article 3bis), and ensures non-discrimination in purchases by SOEs (Section II, Article 3bis(3) subparagraph a). The CAI also ensures transparency in service sector subsidies, requiring notification and information provision, an aspect which has been lacking in the WTO framework (Section III, Sub-section 2 Article 8). Forced technology and confidential business information transfers are expressly forbidden in the CAI, with the strongest language to date (Section III, Sub-section 1, Article 3). Lastly, European firms are given access to standard setting bodies in China, as well as enhance transparency, predictability and fairness in the authorization process (Section III, Sub-section 2 Article 7). With regards to sustainable development, this has been a priority in EU trade policy since the 2015 'Trade for All' strategy (European Commission, 2015). It signifies the first time that China commits itself to clear environmental and labour standards in an investment or trade agreement. Both sides commit themselves to the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement (Section IV, Article 6) and Corporate Social Responsibility standards. An article that drew a lot of attention is a commitment by China to make "continued and sustained efforts" to ratify International Labour Organization (ILO) conventions no. 29 and 105, which ban the usage of forced labour for any reason (Section IV, Sub-section 3, Article 4). Comparing the article with a very similar commitment in the EU-Vietnam FTA (Art 13.4 3(a)), it is identical apart from the additional "on its own initiative" in the CAI, which grants China some leeway. The sustainable development section is excluded from state-to-state dispute settlement (SSDS) and instead, issues are resolved through consultations and a Panel of Experts. The process is very

transparent, documents are made public as well as public hearings, which allow for civil society participation but there are relatively few binding mechanisms. Lastly, enforcement of the CAI is facilitated by SSDS, a monitoring mechanism as well as high-level working groups. Generally, it is accepted that enforcement in the CAI is quite weak (García-Herrero, 2021; Huotari, 2021; Godement, 2021). The EU has in the past been more willing to use WTO dispute settlement mechanisms than the enforcement provisions in its own bilateral treaties (Weiß & Furculita, 2020). Between 2008 and 2016 China accounted for one third of all cases the EU has brought to the WTO dispute settlement body (Evenett, 2016).

Defensive investment strategy

The first new instrument that was proposed by the EC was the EU FDI screening mechanism, intended to preserve European strategic interests. The screening mechanism allows for an exchange of information among member states and the Commission and allows the EC to issue non-binding opinions when an investment forms a security/public order threat to other member states or a Union interest (European Commission, 2020f). Union interests are projects like Horizon 2020 or regarding critical infrastructure, critical technologies or inputs (EUR-Lex, 2020). The mechanism also obliges member states to adopt minimum standards for national screening and notify EU institutions.

Then, the adoption of an International Procurement Instrument intended to leverage countries to open their public procurement markets, which had been proposed as early as 2012, gained new momentum with support from business associations (Titievskaja, 2020; BusinessEurope, 2020; BDI, 2021). The EC also proposed a reform to the EU Trade Enforcement Regulation 654/2014 in December 2019, that has since been adopted (EUR-Lex, 2019a). The amended regulation allows for immediate retaliation upon uncovering a breach in trade rules, which is itself a breach of WTO rules (Weiß & Furculita, 2020). However, WTO Appellate Body appointments were blocked by the US since early 2019 and became dysfunctional on December 10th 2019 (Rathore & Bajpai, 2020). Filing an appeal at the WTO effectively meant blocking a panel report and any action (such as retaliation), since cases remain frozen while appeals are pending and without the Appellate Body they will remain pending (Hillman, 2021). The amended regulation allows the EU to defend itself while the WTO dispute settlement remains offline. On June 17th 2020, the EC released a white paper looking into legislation against foreign subsidies that distort the Single Market. The regulation – which was eventually proposed on May 5th 2021 – is certainly aimed in large part at Chinese SOEs, which

the EC explicitly singles out by stating “Chinese direct and indirect subsidies to State owned enterprises (SOEs) have amounted to 1.3 – 1.6% of annual GDP in recent years” (European Commission, 2021c, p. 5). The EP adopted an amendment to the export control regulation of dual-use items in October 2019, which has been a foil to Chinese civil-military fusion (EUR-Lex, 2019b). Furthermore, President von der Leyen in her action-list following the September 2020 State-of-the-Union, proposed a due diligence legislation pressuring EU companies to act sustainably and ban the usage of forced labour, as has been reported in Xinjiang (Zamfir, 2020). As well as a proposal for an ‘anti-coercion instrument’ against countries that seek to pressure member states into adopting or withdrawing certain policies (von der Leyen, 2020). Considering these defensive instruments – including the new CTEO post – the EU has clearly taken active steps to restrict free flows of investment and boost enforcement that contradict the EU’s long held commitment to liberal open-markets philosophy. Therefore, it is all the more interesting that the EU has chosen to strike a deal with China in the final hours of 2020.

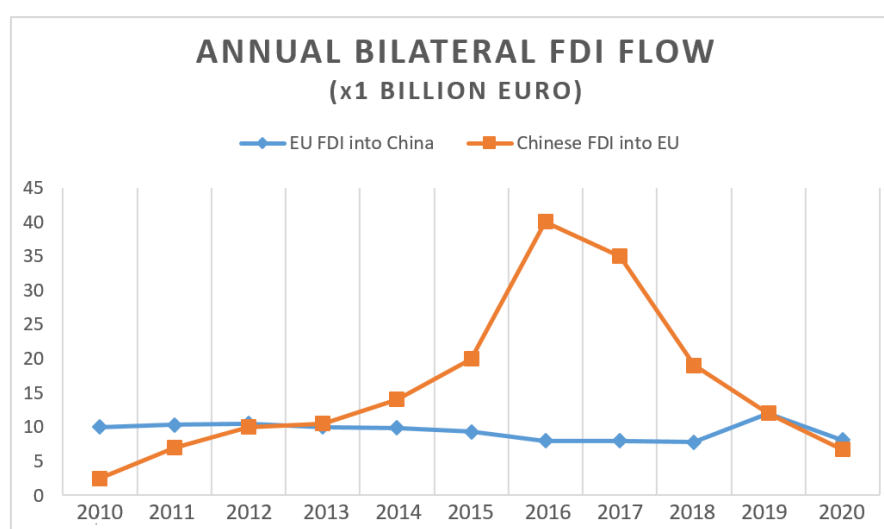
The road to CAI

In November 2013 the EU started negotiations with China on an investment treaty. The EU’s primary objectives were to improve legal certainty for European investors in China, improving protection of investments, reducing access barriers and increasing bilateral FDI (European Commission, 2013a). China’s original aims were to establish a uniform framework of investment protection replacing the patchwork of 25 BITs, increase China’s attractiveness as investment location and safeguard existing openness in the EU (European Commission, 2013a). As will be shown later, the latter has only grown in importance since 2013. An investment treaty would be a ground-breaking agreement in terms of EU-China relations, the first since the Trade and Cooperation Agreement (TECA) of 1985 (ibid.). Already prior to TECA, individual member states were negotiating and concluding BITs with China as it was opening up, Sweden being the first in 1982 (UNCTAD, 2021).

Today, every European country has a BIT with China (Belgium and Luxemburg have a joint agreement), with the exception of the Republic of Ireland (European Commission, 2013a). Of concern to both the EU and China at the start of the negotiations for the CAI was that these BITs varied considerably. Broadly, the BITs could be distinguished between fourteen pre-1998 BITs and eleven post-1998 BITs, the newer ones being of higher quality. For example, pre-1998 BITs (in contrast to post-1998 BITs) do not contain post-establishment national treatment,

no ISDS and no judicial review clause on expropriations (Grieger, 2020). On the whole, all agreements displayed the dynamic of capital-exporting developed countries (EU) with open markets for investment, and a capital-importing developing country (China) whose closed investment regime is reflected in all BITs. Since then, EU-China investment relations have evolved in accordance with China's growing importance in the world economy. China scored 0.625 on the OECD FDI Restrictiveness Index on the earliest available data point of 1997, 1 meaning completely closed from FDI, 0 completely open (OECD, 2021). In 2013, China scored 0.432 and in 2020 it stood at 0.214. EU member states have always been fairly close to zero, with only two countries above 0.100 in 2020 (OECD, 2021). Thus, China has become less restrictive regarding incoming FDI, but it has also become a much bigger capital exporter since it acceded to the WTO in 2001 and particularly after 2010. The graph below displays how China's annual outbound FDI into the EU was larger than the reverse into China from 2013-2019. Chinese FDI into the EU before 2010 amounted to very little. In 2019 EU FDI into China is pushed up significantly due to one mega acquisition by Heineken of €2.7 billion (Heineken, 2019, p. 111). Bilateral investment has been completely lopsided, whereas China almost exclusively conducts M&As to acquire technology, by far most of the EU's FDI has been greenfield due (in part) to legal limitations (Rhodium, 2021). Businesses in Europe often blame the EU's stagnant FDI into China on Chinese restrictions on investment and discrimination against foreign firms, which the investment treaty intended to ameliorate (BusinessEurope, 2017).

Figure 1



Note. The graph is based on quarterly and annual data from the Rhodium Group and Mercator Institute for China Studies (Hanemann & Huotari, 2015; Rhodium, 2020; MERICS, 2021).

An EU-China investment treaty was not the first attempt by the EC to reinvigorate economic relations with a growing China, the EU worked to institutionalize cooperation before. In fact, in 2007 the EU and China began negotiations on a Partnership and Cooperation Agreement (PCA), a type of association agreement like the EU has with many Eastern-European and Central-Asian states. The scope of the intended agreement was quite broad and ambitious; including investment, fair competition, intellectual property rights and public procurement (European Commission, 2009). The PCA stalled in 2009 and failed for a number of reasons, never to be mentioned again in EU records after 2013. First of all, the EU was the demanding partner in the negotiations asking China to install sweeping reforms with very little to offer in return due to the EU's openness. After the Euro crisis began late 2009, the EU's focus was elsewhere and China – who aided the EU economies by buying bonds – had very little appetite to acquiesce to European demands (Yan, 2015). Secondly, the Treaty of Lisbon came into effect late 2009, which granted the EC FDI as exclusive competency and allowed for a uniform investment treaty with China, but a PCA could not legally replace the existing BITs. Third, the PCA proved to eventually be unfit for the demands by either side. The EU wanted liberalization in non-services, which was not part of the mandate of Chinese negotiators, while the Chinese side primarily wanted investment protection, which was not covered by the EC's mandate since negotiations predated the Lisbon Treaty (European Commission, 2013a).

An impact assessment by the EC published in May 2013 reconsiders the conundrum of EU-China economic relations and explores five policy options: no change, a standalone investment agreement replacing the 25 BITs, a standalone investment agreement combining market access and protection, expanding the PCA negotiations or an FTA. The last two were deemed unviable and of the first three option the choice eventually landed on a standalone investment agreement combining market access and protection (European Commission, 2013a). The report concludes by asking the Council to authorize negotiations with China. The publication of the authorization coincided with a restart in negotiations between the USA and China for their BIT, which had initially begun in June 2008 but were halted a year later (Xinhua, 2013). The US Trade Representative noted China's increased ambition regarding the BIT and negotiations resumed fully in July 2013, six months before EU-China negotiations officially began (USTR, 2013). The impact assessment also explicitly calls out China's other recent BITs with economic competitors of the EU such as – indeed – the US, Canada, Japan, South-Korea, and states: "It is possible that China could grant preferential access as well as more comprehensive protection standards and transparency to other trading partners, which would

put EU investors at a competitive disadvantage.” Therefore calling on the Council to realize the urgency of an investment agreement and not fall behind economic competitors of the EU, in line with neo-mercantilist expectations (European Commission, 2013a, p. 18).

Negotiations officially commenced in January 2014. However, analysis of public records reveal that negotiations quickly entered a stalemate around the scope of the agreement, definitions, minimum standards of treatment and transparency. In December 2017 negotiations were suspended briefly and Trade Commissioner Cecilia Malström called on Chinese President Xi, at Davos, to step up in terms of promised openness (Malström, 2017). Negotiations resumed with the 13th round in May 2017. The Chinese side may have deliberately stalled negotiations to benefit from asymmetrical access, considering that – as the graph shows – Chinese FDI into the EU was booming. They were mostly M&A investments by SOEs into high-tech enterprises (Rhodium, 2020). The enormous spike in inbound FDI from China in 2016 for the first time alarmed the EU and its member states. Prior to 2016 the prevailing mood in Europe regarding investment from China is best summed up by Trade Commissioner Karel de Gucht in 2012: “we need the money” (De Gucht, 2012). In the same speech he predicted a significant rise in Chinese investment and focused on high-tech sectors, which he celebrated as a great opportunity for Europe. Simultaneously, De Gucht rejected any EU-wide investment screening as “neither desirable nor feasible in my view”, a view that persisted for years (European Commission, 2013b, Meunier, 2017, p. 13). The immediate cause of the change of position in the EU was a U-turn by the German government, Germany had always been most positively predisposed towards Chinese investment (more on that later), certainly as opposed to the more cautious French government (ETNC, 2017). In mid-2016 Chinese appliances company Midea acquired KUKA Industrial Robots for a record €4.6 billion, a ‘crown-jewel’ of German industry, and Fujian Grand Chip Investment (FGCI) attempted to acquire Aixtron, a semiconductor equipment manufacturer (ibid.). Over transparency issues the German government withdrew approval for the latter in October 2016 and even the American Committee on Foreign Investment (CFIUS) got involved regarding the US division of Aixtron, which led FGCI to drop the bid (Hooijmaaijers, 2019). The German government was rattled by the aggressive take-over (bid) and shifted its position, in part to ensure the future viability of German industry. In February 2017 Germany, Italy and France sent a joint letter to the EC outlining their concerns regarding a lack of concrete rules and common screening for inbound investment (ETNC, 2017). In late July the governments provided more detail and by September 2017 the EC published a proposal for a European FDI screening mechanism (EUR-Lex, 2017).

Coming into 2018 both sides replaced their Chief Negotiators, now Maria Martin-Prat for the EU and Li Yongjie for the PRC headed bilateral talks (European Commission, 2018). It took four and a half years for the two sides to exchange market access offers in July 2018. Progress was remarkably scant, only three negotiating rounds were held in 2018. Records reveal a lack of high-level engagement from the Chinese side, who were apparently more preoccupied with the trade war with the US (Grieger, 2020). The EU side grew increasingly frustrated with China's assertive posture abroad but dilatory posture at the negotiating table. Sabine Weyand, Director-General of DG Trade noted that negotiations were "pretty dormant" at that time (TradeTalks, 2021). At which point in early 2019 frustrations in Brussels boiled over, to demand a new posture vis-à-vis China. On January 10th 2019, the Bundesverband der Deutschen Industrie (BDI) published a position paper describing China as a systemic competitor, a global power and an economic competitor and partner, and also provided actions to strengthen the EU and its defensive instruments (BDI, 2019). It was a historic move by one of Germany's most prominent business associations, particularly considering that German industry has long been one of the most supportive constituencies for good relations with China. On March 12th the EC published its own 'strategic outlook' regarding EU-China relations, calling China a "cooperation partner", a "negotiating partner", an "economic competitor" and a "systemic rival promoting alternative models of governance", which mirrors the language in the BDI paper (European Commission, 2019b, p. 4). It was a clear departure from previous strategies regarding China (European Commission, 2013c, 2015, 2016).

On March 18th Chinese foreign minister Wang Yi and EU High Representative Federica Mogherini held the planned EU-China Strategic Dialogue. At a press conference afterwards, Wang was eager to show alignment with the EU, consistently mentioning 'win-win cooperation' (European Council, 2019a). Mogherini emphasized that the strategic outlook was at least in part aimed to start an internal debate, therefore incentivizing China to adjust its positions. The Foreign Affairs Council with foreign ministers from all EU member states convened to discuss a "more realistic, assertive and multi-faceted" approach vis-à-vis China. Wang joined the ministers for an informal lunch in the afternoon where he likely conveyed China's displeasure with the EC calling China a systemic rival, Weyand admitted as much, adding that: "they [China] have been trying to convince us to see them more as a negotiating partner" (TradeTalks, 2021). China, under intense pressure from the US Trump Administration, wanted to prevent becoming isolated and sought alignment with the EU against American tariffs and unilateral actions. On March 19th the EU FDI screening mechanism was adopted (EUR-

Lex, 2019c). From 21-22 March the European Council held a summit with all government leaders, in preparation for the EU-China summit. At the Council meeting the EU reiterated prior demands for market access and a level playing field (European Council, 2019b). Meanwhile, President Xi was nearby in Rome accompanied by President Mattarella, to sign the cooperation agreement with Italy regarding the Belt and Road Initiative. Later, President Macron of France received Xi in France for a state dinner on the 25th in Paris and invited German Chancellor Merkel and President Juncker for separate and quadrilateral meetings with President Xi (Tiezzi, 2021). Finally, on April 9th the EU and China held their summit with President Juncker and Tusk for the EU and Premier Li Keqiang for China. The analysis has revealed it was at this point that negotiations kicked into high gear with sufficient 'high-level engagement' this time, after the EU had pushed back against China (European Commission, 2019c). Also, at this summit both sides committed to the deadline of concluding the agreement before the end of 2020, as presumably had also been agreed privately between Xi, Merkel, Macron and Juncker days earlier (European Council, 2019c). The erstwhile (bilateral) investment treaty under negotiation became known as the CAI. Negotiation rounds started to be scheduled every month by late 2019, six in total in 2019 and ten in 2020, out of a final total of 35. However, as negotiations kicked into high gear, the EU started proposing a range of trade defence instruments, as detailed earlier, in addition to the common FDI screening mechanism.

Negotiations continued to progress in 2020, having established the standards of treatment, with the main points of friction being; SOE disciplines, subsidy transparency, market access offers and sustainable development provisions. At the June 22nd 2020 virtual EU-China summit, attended by Xi, Li, von der Leyen, President Charles Michel and Josep Borrell, little progress was made and they could not agree on a joint communiqué. The failed summit sparked considerable doubt among observers about the possibility to get an agreement before the deadline (Wuttke, 2021). On July 1st Germany took over the rotating Council of the EU presidency. Germany under Chancellor Merkel has been one of China's best friends in the EU, reflecting her governments concern for the profitability of German industry, which is reliant on China as a key export market (Barkin, 2021; Zenglein, 2020). Merkel has visited China frequently, often accompanied by the CEOs of Germany's biggest companies such as Volkswagen and Siemens, and she has been present for many signing ceremonies between German and Chinese businesses (Barkin, 2019). As a result, EU-China relations were given priority under the German presidency. The Sino-German partnership has its origins in the Financial Crisis, when the Chinese eventually came to the rescue of the Euro and German

exports to China soared (Barkin, 2021). In 2014 the two countries became ‘comprehensive strategic partners’ and have held six biannual cabinet-level consultations since 2011 (Bundesregierung, 2021).

On September 14th the EU and China held a leaders’ meeting which was widely perceived to have been the occasion on which the CAI could’ve been signed (BDI, 2020a; Poggetti, 2020; Bruegel, 2020). Confirmed by the fact that originally all member states’ leaders were scheduled to participate (European Council, 2020a). The participants lauded progress that had been made regarding forced technology transfers, SOE disciplines and subsidy transparency but called for more work on market access and sustainable development. The EU in particular wanted more access in agri-foods, financial services and the digital sector (ibid.). The most complicated issue to resolve in the end proved to be regarding sustainable development, labour (ILO provisions) and the mechanism for addressing differences, to which the last negotiating rounds returned to again and again (European Commission, 2021d; TradeTalks, 2021). A press release after a special Council of Ministers meeting on 1-2 October 2020 called on China to be more ambitious in tackling climate change and expressed concern regarding the “treatment of people belonging to minorities”, omitting any reference to market access or level playing field (European Council, 2020b). However, only a week earlier on September 22nd Xi had already committed China to carbon neutrality in 2060 (Xinhua, 2020).

As December 2020 dawned, a finished agreement still seemed quite distant considering the differences. It was also at this point that the political leaders took control over the negotiations from their respective negotiating teams. It has been reported that the German trio: Angela Merkel, Sabine Weyand and Ursula von der Leyen were running negotiations in the final month (Hanke, Leali & Moens, 2021). However, particularly Merkel had promoted the issue to ‘*Chefsache*’ and was determined to get an agreement before Germany’s term as Council President expired (Wettach, 2020). In early December the EU made a new offer to China – in order to incentivize progress on the outstanding issues – offering access to European electricity trading and renewable energy (Weyand, 2021a; García-Herrero & Xu, 2021). A breakthrough came on December 18th when the EU received – and DG Weyand subsequently briefed EU ministers about – a new and surprising offer from the Chinese. However, apparently discord erupted among EU member states about the sudden haste by both Merkel and the Chinese to conclude an agreement (Lau, 2021). On December 22nd the Polish foreign minister tweeted “We need more consultations and transparency bringing our transatlantic allies on board. A good, balanced deal is better than a premature one”, referring to involving the incoming Biden

administration (Rau, 2020). On December 23rd the French junior trade minister complained that the forced labour provisions were too weak and threatened ‘not to facilitate’ the deal, adding that Belgium, the Netherlands and Luxemburg shared his reservations (Bouissou, 2020). Scheduled talks between Trade Commissioner Dombrovkis and Chinese vice-premier Liu He on December 22nd were cancelled, as well as discussions on the CAI by EU ambassadors that same day (Hanke, Leali & Moens, 2021). It is unclear what happened in the interim between 22 and 30 December, however, Merkel along with von der Leyen and Weyand continued to pressure member states to agree to the deal. On December 28th all EU leaders were asked to consent to concluding the CAI and none objected. Thus, on December 30th in a virtual call with Xi, Merkel, von der Leyen, Michel and Macron, the EU and China officially concluded in principle the negotiations for the CAI. Merkel evidently enlisted Macron in pushing for the CAI who was rewarded with a seat at the virtual table on December 30th. The Italian assistant foreign secretary waited one day to voice his displeasure over the timing of the agreement and Macron’s presence at the meeting. Scalfarotto called it ‘rude’ to the incoming Biden administration and raised concerns over the positive signal it gives to China just when they are questioned regarding their human rights practices. Italy had asked for Macron not to be present and only EU representatives (which includes Merkel as President of the Council of the EU). When asked whether they had listened to Italy, Scalfarotto responded: “*evidentemente no*” (Fubini, 2020).

Chapter 5. Empirical Analysis: testing hypotheses

Finally, I will turn towards answering the central research question by probing each hypothesis, dismissing official clarifications and developing a credible explanation grounded in theory. I will first expound the official explanation as stated by the EC and explain why it does not hold ground.

Director-General Weyand has stated on multiple occasions that the CAI was concluded because the negotiating mandate had been fulfilled (Weyand, 2021a, 2021b). However, looking at the original mandate this is simply not the case. Most importantly, the CAI was meant to replace the existing 25 BITs between China and the EU to provide legal certainty for China and a uniform investment regime (since the Lisbon Treaty) for the EU as part of its common commercial policy (Europe, 2013a). In recent years the EU has implemented a reformed two-instance investment court system (ICS) as a form of ISDS in its investment treaties, to eventually be replaced by a Multilateral Investment Court (MIC) (Europarl, 2021b). The CAI failed in this objective, no agreement could be reached regarding investment protection (which includes FET, expropriation and ISDS) and the existing BITs remain in force. The EU has agreed to continue negotiations on ISDS, two years after signature. However, the EU will have very little in terms of leverage to offer China, meaning that the EU will either have to accept massive concessions to China or give up on uniform investment protection. Secondly, especially in the last years the CAI was referred to as a means to ‘rebalance’ EU-China relations towards reciprocity. Although the CAI certainly makes valuable progress on level playing field issues, in itself it falls completely short of its mission. One may even suggest that the EU’s newly proposed defensive instruments – most of which announced in the latter half of 2020 – are an acknowledgement of the degree to which the CAI falls short to rebalance relations. Lastly, even though there is considerable value in the certainty the agreement provides by legally binding China’s unilateral liberalization, it does not comprehensively grant new forms of market access to EU businesses. The EU has progressively accepted less in the agreements it has pursued with China, which is understandable considering geo-economic realities, however EC officials have nevertheless unduly oversold and under-delivered. MERICS President Huotari aptly referred to the CAI as providing “foundations for bridges into an imagined future of fairer competition”, which Commissioner Bretton seemed to acknowledge by calling the CAI an “intention, not more, not less” instead of a deal (Huotari, 2021; Bretton, 2021).

Since the EC did not fulfil the negotiating mandate, the analysis will turn to other explanations that can satisfactorily answer the central research question. Beginning with the hypotheses from neo-mercantilism, process-tracing has led to detailed findings that either disqualify or lend support to the hypotheses.

Neo-mercantilism

H1: maintaining the EU's relative competitive position

Looking at the actions by the EU vis-à-vis China through a defensive prism, one must consider the loss of economic potency by the EU. It is undeniably true that the EU's relative competitive position opposite China has slipped over the past decades. According to WTO data, the EU represented 12% of global trade in 2000, down to 10% in 2020, whereas China grew from 3.6% in 2000 to 15% in 2020 (WTO, 2021). Also, in 2000 the EU accounted for 30% of worldwide value added in manufacturing supply chains, in 2014 that was down to 22%. Meanwhile China grew from 5% in 2000 to 20% in 2014. Reliable data for 2020 is hard to obtain, however, extrapolating from prevailing growth trends leads to the conclusion that today the EU may be at 18% whereas China is at 26%. That would signify a decrease of 40% for the EU and an increase in share of worldwide value added in manufacturing supply chains for China of 420% in twenty years' time (Turégano & Marschinski, 2020).

After analysing the content of the agreement, we can conclude that there is nothing in there which inherently provides for an advantage of the EU opposite China that could reverse the prevailing trend of relative decline in the international economic system. The CAI has the potential to enhance economic interdependence between the two economic blocs, where EU businesses stand to gain from future growth and innovation in the Chinese economy. Even so, those gains are not relative gains in the neo-mercantilist sense, there is no extraction which creates greater benefit for the EU. Besides, the Chinese economy would clearly benefit from the billions of euros in investment that the CAI facilitates through market access and legal certainty. However, although relative gains are critically important, the theory envisions the CAI to be defensive in the sense that it facilitates the maintenance of the EU's current competitive position, therefore halting the outlined decline. The EU would institutionalize and legally safeguard its presence in the China and stake in East-Asia, a region of enormous importance for global value chains and growing share in global GDP (WEF, 2019).

Simultaneously, the articles pertaining to the issue of level playing field potentially have a sizable impact on the competitiveness of European industries. Disciplining SOEs and their market practices, creating transparency and requiring information provision on state subsidies, banning forced technology transfers and protecting business intelligence; all of these are critical issues in the global economy. The INTA commission has signalled its concern with the EU's declining competitive position in China and referenced the agreement as a step in the right direction (Winkler, 2021). The CAI is sufficiently ground-breaking in the sense that China has agreed to these commitments for the first time in an international treaty. The EC has frequently signalled that it sees CAI as a 'springboard' to push these issues forward in the WTO, to improve the multilateral rulebook (Weyand, 2021b). Such progress would mean that – not just in China – EU businesses will find themselves competing with local firms on fairer terms, setting the conditions for potentially improving the relative competitive position of the EU in the international economic system. Therefore, by ensuring the EU's presence in a region of great economic potency and being a building block for multilateral progress on levelling the playing field, the CAI contributes to maintaining the relative competitive position of the EU.

H2: ensuring a first-mover advantage

The second hypothesis sees the CAI as an offensive move by the EU to gain a degree of access and investment protection in China through a new-generation BIT which exceeds that of other large trade partners of China. A first-mover advantage would allow EU businesses to deepen their presence on the Chinese market and enjoy elevated standards of protection which ensures a larger market share and comparative advantage. China became the EU's largest trading partner in goods in 2020 (\$709 bn.), overtaking the US (Eurostat, 2021). Meanwhile, ASEAN became China's largest trading partner in 2020 (\$732 bn.), surpassing the EU, now no. 2 (MOFCOM, 2021a). The research looked at China's largest trading partners as the EU's main competitors: ASEAN, the USA, Japan, South-Korea, Australia and Brazil (Statista, 2020).

The picture that emerges upon analysing the existing BITs and investment chapters in FTAs that China has signed with each of these states is that the EU's motives for CAI cannot be explained as a desire of a first-mover advantage, but rather the EU trying to catch up. As an emerging state apparatus, the EU has a disadvantage vis-à-vis its economic competitors in terms of its autonomous ability to act due to the complexity of European institutional checks and balances. The main competitor the EU has sought to catch up with through the CAI has been

the United States. The US and China originally decided to start BIT negotiations in June of 2008, before the EU acquired its FDI competency (Cai, 2009). Later, negotiations were suspended but restarted in July 2013 before the EU started its negotiations for the CAI.

However, the Trump administration once again suspended talks on a BIT and instead started a trade war with China. The US-China trade war eventually led to the Phase One trade deal both sides agreed to in December 2019 and President Trump and Vice-premier Liu He signed on January 15th 2020. Since the Phase One deal is not officially a treaty, but rather signed as an executive order, it was able to enter into force very rapidly on February 14, 2020 (USCC, 2020). The US did not consult the EU prior to concluding the Phase One deal and the deal was very bad for the EU. The Phase One deal was widely regarded as ‘managed trade’, one of its most contentious aspects are the purchasing commitments China made amounting to an additional \$200 billion in US goods compared to 2017 in manufactured goods, services, agricultural products, and energy, envisioned for 2020 and 2021 (USCC, 2020). The Kiel Institute for the World Economy estimated that the EU would suffer greatly from trade diversions caused by the Phase One deal. Compared to a 2021 benchmark without the deal, \$11 billion of EU exports to China are negatively affected by trade diversions. It inevitably means that EU businesses lose market shares in China. The most negatively impacted sectors are aircraft orders & deliveries (-3.8\$ bn.), vehicles (-2.4\$ bn.) and industrial machinery (-1.4\$ bn.) (Chowdhry & Felbermayr, 2020). Shares in aggregate Chinese imports in 2017 versus 2021 under the deal change most for the EU there where they are the strongest: in manufacturing. Aircrafts drop from 41% to 29%, whereas aircraft imports from the US rise from 55% to 69%. In vehicles EU goes from 56% to 51%, whereas the US increases from 24% to 30%. In optical and medical instruments, the EU goes from 31% to 28%, while the US from 25% to 31% (Chowdhry & Felbermayr, 2020). Germany stands to lose most from the Phase One deal; \$4.3 billion in exports to China, and accounts for the majority of the EU’s potential losses in the automotive sector (BDI, 2020b).

Purchasing commitments are not included in the CAI, but not for lack of trying, China offered to buy more European goods at the September 2020 summit in order to remedy EU demands (García-Herrero, 2020). The EU refused to engage in managed trade, which is against WTO rules, as the US did as well under President Obama, according to an encounter he had with then Chinese Premier Wen Jiabao (Obama, 2020). However, it is uncertain to what degree China will succeed in its purchasing commitments, meanwhile other aspects of the Phase One deal hurt European competitiveness vis-à-vis American businesses. Firstly, nothing in the Phase

One deal is granted on an MFN basis, meaning that China's commitments are solely to the US. Commitments include (among others): all JV requirements and equity caps in banking, insurance and asset managements are lifted, access to cloud services (max. 50% ownership) e-payment services and credit rating services, bans on forced technology transfers and other IPR protections (Hu, 2020). The disadvantages for the EU were most acute in the financial services sector. The EC was clearly frustrated with the US and the gains they acquired unilaterally, to the detriment of the EU. A September 2020 briefing from the EP noted that the EU sought the same concessions as China granted the US (Grieger, 2020, p. 8). Director-General Weyand stated afterwards; "there is no reason for us to accept to suffer from an uneven playing field, including vis-à-vis US investors in China, for a longer time. We had to play catch-up, because the Phase One put EU companies at a disadvantage so you know why should we sit still?" (Weyand, 2021b). The CAI managed to achieve largely the same level of market access and level playing field commitments, as far as investment is concerned. The CAI has SOE disciplines which the Phase One deal did not, while the Phase One deal may provide more substantial financial services access than CAI does (Hu, 2021). Hence, the EU was catching up to the US, not trying to achieve a first-mover advantage.

As for the other competitors, another agreement which sent shockwaves through European industries was the Regional Comprehensive Economic Partnership (RCEP) (BDI, 2020c, VDMA, 2020). Now, RCEP is not an investment agreement and even as an FTA it is considered relatively old-fashioned, dealing mainly with tariff reductions and harmonizing rules of origin. However, RCEP encompasses 15 countries comprising 30% of the global population and global GDP. RCEP was signed early November 2020 and for the first time introduced preferential trading among China, Japan and South-Korea (Green, 2021). The EU is locked out of the agreement and RCEP will inevitably strengthen regional economic ties to the detriment particularly of EU firms not located in the participating countries due to strict rules of origin (VDMA, 2020). Like the CAI, RCEP pushes ISDS negotiations forward by two years and although it offers national treatment, it also introduces a raft of exceptions (BDI, 2020c). RCEP certainly played into EC and German calculations regarding concluding the CAI, to remain relevant in the region as the economic centre of gravity shifts to the East (Wuttke, 2021).

Japan has a BIT with China dating back to 1989, the China-Japan-Korea trilateral investment treaty (CJK TIT) from 2014 and RCEP. Japan gets to freeride off China's commitments in other FTAs and BITs regarding investment because their 1989 BIT does not contain a REIO (regional economic integration organization) exception, however

implementation is hard because there is no ISDS in the BIT (UNCTAD, 2021). The 1989 BIT affords post-establishment national treatment but with a major caveat: “it shall not be deemed treatment less favourable for either Contracting Party to accord discriminatory treatment [...] in case it is really necessary for the reason of [...] sound development of the national economy” (Protocol, Article 3). Another clause also reserves the right to prescribe ‘special formalities’ to foreigners (Protocol, Article 4). CJK TIT did not provide for pre-establishment national treatment which is something Japan wants desperately (Hamanaka, 2017). The CJK TIT basically reiterates that the 1989 BIT still stands and so nothing really changes but it does contain ISDS and qualified Fair and Equitable Treatment (FET) and an explicit clause on the prohibition of performance requirements (all absent from the BIT). The CAI draws even on many of these issues such as performance requirements, post-establishment MFN and national treatment and even prohibits ‘special formalities’, allowing only ‘ordinary formalities’ (Section II Article 4(2)). However, in terms of investment protection it is inferior, considering the lack of FET, measures against indirect expropriation and ISDS.

As for the Republic of Korea, it has an updated BIT since 2007 with China which is fairly balanced and up to standards, with post-establishment NT, with pre- and post-MFN, unqualified FET, and containing ISDS & SSDS. The Korea-China FTA that also covers investment has qualified FET (referencing only minimal standard treatment customary to intl. law), all else being even. Australia has a 1988 BIT, a 2003 Framework Agreement and 2015 FTA. The agreements are definitively not up to EU standards and lopsided in China’s favour. There is no conclusive national treatment clause, there is no FET at all in the FTA (but there is unqualified FET in the BIT), no prohibition of performance requirements. There is pre and post MFN. There is very limited protection against expropriation and indirect-expropriation is not defined. Overall both contain many exceptions and the FTA provides a right to regulate. Brazil has no BIT or FTA-with-investment-chapter with China at all. Lastly, ASEAN has an investment agreement with China since 2009 which grants NT but with a lot of exceptions including allowing for new non-conforming measures, according to a legal scholar it; “allows a party to withdraw the non-discriminatory treatment of foreign investors in the future, without violating its national treatment and/or MFN obligations under the Agreement” (Xiao, 2011, p. 249). The 2009 agreement coexists with BITs with individual member states which are all of low quality equal to the pre-1998 BITs China has with EU member states. It is generally agreed that the new BIT is better at protecting investors, though no liberalization but it does grant post-establishment NT as well as pre- and post-MFN (UNCTAD, 2021).

On the whole, Japan, Korea and ASEAN definitively have a level of treatment that the fourteen pre-1998 European BITs do not have, particularly for those treaties CAI would allow the EU to catch up significantly. Certainly, the Phase One deal was also on the minds of EU leaders when they concluded the CAI with China. Thus, H2 can be rejected as there was certainly no first-mover advantage to be attained by the EU.

H3: facilitating contradicting interests rooted in heterogeneous competitiveness

Differences in relative competitiveness in different industries creates divergent needs in terms of protection and promotion, weak industries need to be protected and highly-competitive ones need to compete globally. Through that prism, the FDI screening mechanism can be seen as an instrument to protect vulnerable European companies from large profligate Chinese SOEs, whereas the CAI accommodates the EU's top performers in China. The FDI screening mechanism is certainly not described by EC officials in those terms. Maria Martin-Prat, the EU's chief negotiator for the CAI, called the screening mechanism a security tool, which is not incompatible with the CAI (European Commission, 2020e). However, there are other more explicit trade defence instruments in the works that do contradict the openness of EU markets which the CAI ensures. The proposed foreign subsidies regulation and amended trade enforcement regulation are prime examples.

Nevertheless, it is unwarranted to state that these instruments protect specific industries, rather do they tackle supposedly unfair competition posed by Chinese companies operating in the EU. The EU FDI screening mechanism also does not so much prevent acquisitions in uncompetitive industries, as it prevents acquisitions in strategic sectors where the EU seeks to limit dependence on foreign companies. It plays into the new European Industrial Strategy from March 2020, which was updated again in May 2021 with a new study on strategic dependencies. The in-depth review revealed strategic dependencies in crucial sectors: raw materials, batteries, active pharmaceutical ingredients, hydrogen, semiconductors and cloud and edge technologies (European Commission, 2021e). The COVID-19 pandemic played a large role in revealing certain dependencies that the EC is looking to eliminate in the future with its Industrial Strategy and – inter alia – pooling European resources through its Important Projects of Common European Interest (IPCEI) forum (ibid.). However, the CAI did provide China with sufficient certainty that the European market will remain as liberal and open towards Chinese investment as it has been in the past, perhaps limiting EU policy space for reducing dependencies.

The European Industrial Strategy can be explained as an effort by the EU to regain the dominance it has lost in global manufacturing supply chains, as was demonstrated with H1. Moreover, the inbound investment in tangible assets in the EU has been on the decline, particularly since 2008 (ECB, 2018). Tangible assets refers to physical property, plants and equipment. Meanwhile, intangible investment has been growing and outpacing tangible investment into the EU (ibid.). Since 2016, over 90% of Chinese FDI into the EU has been M&As, whereas the EU has mostly invested in tangible assets in China (Rhodium, 2021). The defensive strategy could therefore be explained as a move by the EU to deter M&A investment and incentivize greenfield investment into the EU, in order to support their green and digital transition ambitions as expressed in the European Industrial Strategy, and boost manufacturing output (European Commission, 2021e). Hence, the defensive instruments do not protect uncompetitive industries, but work to limit dependencies and improve European industrial capacities.

On the other hand, the CAI clearly accommodates its top performing businesses operating in China. This is also where Germany's role as President of the Council of the EU becomes important. Between 2000 and 2020 the value of completed EU-27 and UK FDI transactions in China totalled \$204 billion, Germany accounted for 33% of that total, if we exclude the UK it even rises to 40% of all EU FDI into China (Rhodium, 2021). More than France, the Netherlands and Belgium (numbers 3, 4 and 5 after Germany and the UK) combined. The EU runs a large trade deficit with China while Germany is only one of three countries in 2020 that had a trade surplus with China, worth €14 billion (Eurostat, 2020). Furthermore, Germany accounts for 48.5% of all EU exports to China and 2020 was the fifth year in a row that China was Germany's largest trading partner (Zenglein, 2020). Most of German FDI is coming from a handful of large multinationals in the automotive and chemicals sectors: Volkswagen, Daimler, BMW, BASF and Bayer (ibid.). BASF and Bayer were also two companies that participated in the public consultations prior to the start of negotiations (European Commission, 2013a). Other companies of note are the largest European insurance companies: AXA and Allianz, as well as Airbus, Infineon and NXP. The latter three are all dependent on China for a plurality of their sales, although the benefits of CAI for these companies is less explicit than for the others (Zenglein, 2020). Back in 2017, 50% of surveyed European companies present in China reported to BusinessEurope that they would increase investments if given more market access (BusinessEurope, 2017).

The automotive sector clearly benefits from the CAI, as indicated earlier, through the certainty provided by making prior liberalizations binding and granting exclusive NEV market access. Also, investment in NEVs is completely unrestricted once it exceeds \$1 billion (Annex X), which clearly favours established companies such as Germany's Big Three. Volkswagen was an early entrant in the Chinese market, dating back to 1978. Owing to its deep roots, China represented 42% of global vehicle sales of the Volkswagen Group in 2020 (Volkswagen, 2021). Additionally, Volkswagen China Group has a combined market share of 19.4% on the Chinese car market, far more than its nearest competitor Honda (7.3%) (Demandt, 2020). However, the revenue made by VW does not all belong to VW, the company has three major joint ventures with Chinese brands SAIC (50/50), FAW (40/60) and JAG (75/25) (Volkswagen, 2021). The former used to be a 50/50 JV, however, VW announced it would take control over the JV as well as take a 50% stake in its erstwhile partner JAG, the \$1 billion deal is completed in 2022 when the reform takes effect (Murray, 2020). Its control over what is now Volkswagen (Anhui) Automotive Company is crucial for the future of VW in China, focusing on state-of-the-art MEB (Modularer E-Antriebs-Baukasten) platform production for its electric vehicles. VW also acquired a 26% stake in battery manufacturer Guoxuan High-Tech Co, becoming the largest shareholder, and plans to build its own battery assembly on site. Starting from 2023, VW plans to export MEB-EVs from China to Europe (Volkswagen, 2021). VW's annual report noted the importance of control over battery production for EVs: "The battery accounts for 20% to 30% of the cost of materials in electric vehicles; in future, it will be one of the most important components when differentiating between products" (p. 147). Increasingly, China has become very important as a leading market for R&D related to electric vehicles and self-driving cars. Thus, the CAI is essentially an insurance policy for VW to protect their immensely valuable investments in e-mobility, upon which the future of the company depends. VW CEO Herbert Diess has been an outspoken proponent of the CAI (Chen, 2021). The Chinese Deputy Minister of Commerce Yu Jianhua even noted that he expects VW will help develop bilateral trade and economic relations between China and Germany, to which Volkswagen China Group CEO Stephan Wöllenstein responded that VW will act as a "bridge" to improve mutual trust between China and Germany and China and the EU (MOFCOM, 2021b).

Although to a lesser degree, the other corporations find themselves in similar circumstances as Volkswagen. Daimler A.G. is not as dependent on China for its global revenue, but its star brand Mercedes Benz still sells 36% of its vehicles on the Chinese market (Daimler, 2021). Daimler also acquired a stake in a Chinese battery cell manufacturer, Farasis

Energy (Ganzhou) Co. Ltd. Daimler has been trying since 2018 to gain control over their joint venture (Beijing Benz Automotive Co.) with Chinese partner BAIC Group. Daimler has a minority 49% stake (Zhu, Taylor & Sun, 2019). BMW A.G. was the first to announce to take full control over their Chinese JV BMW Brilliance Automotive, paying \$4.2 billion to enlarge its stake from 50% to 75%, to be completed in 2022 (Shirouzu, 2018). The announcement was accompanied by a notice that BMW would spend \$3 billion to enlarge existing production facilities, exactly the investment China likes to see, evidenced by the approval of Premier Li. BMW sees China as a future origin of innovation (ibid.). Chemicals giant BASF has been increasing its presence in China as the government relaxed JV requirements. In July 2018 BASF signed an agreement to invest \$10 billion (spread out over a decade) in its first wholly-owned facility in Guangdong, in the presence of Chancellor Merkel and Premier Li (Mitchell, 2018). It will be BASF's third largest facility in the world. The CAI underwrites these liberalizations in the chemicals sector as well. A day before the CAI was concluded, BASF announced a strategic partnership with the Chinese Academy of Social Sciences. The Chinese chemicals market has a world market share of 40% (BASF, 2021). Allianz has also taken control over its JVs: China's first wholly foreign-owned insurance holding company in January 2020, approval for a wholly-owned insurance asset management company in January 2021 and in February 2021 Allianz China Life was announced to become a wholly-owned subsidiary of Allianz China Insurance Holding, buying the stake from Chinese partner CITIC Trust (Allianz, 2020; Olano, 2021; Allianz, 2021). The other insurance giant AXA, gained approval in September 2019 to take 100% control of its JV AXA Tianping Property & Casualty Insurance, becoming China's biggest foreign-funded P&C insurer (AXA, 2021). Both insurance companies are eyeing the growing Chinese middle class as a key opportunity, and have an advantage in China vis-à-vis their non-Chinese competitors.

In conclusion, the image is strikingly similar across these businesses and sectors. All of them are trying, have or will succeed in taking control over their joint ventures in China. This will afford each a much larger share of the profits, in a country which every single one of these companies considers a key growth market. The pandemic already ensured that China was one of the few countries – if not the only for these companies – where growth could be registered. Although the CAI provides for the legal certainty, it did not break ground on many of these liberalizations (except for NEVs). China had already unilaterally scrapped JV requirements. The trade instruments don't protect specific sectors or companies that are less competitive than Chinese competitors. Hence, this hypothesis is not supported by the data.

H4: pre-emptively countering shirking behaviour

Potential shirking behaviour is a danger embedded in the dependence the EU has as the principal demanding market access and investment protection vis-à-vis China as the agent with control over their home market. The treaty would have to contain dispute settlement and monitoring mechanisms not previously afforded to the EU in order to deter China from reneging on prior commitments. Although the enforcement mechanism is not as strong as in other trade and investment agreements by the EU, it is still sufficient to deter shirking. The EC as well as the INTA committee in the EP have publicly expressed fears that China would roll back the unilateral market liberalizations it has enacted over the past few years (Winkler, 2021; Weyand, 2021a; 2021b). As stated earlier, the CAI does not afford as much new access as it legally binds the progress China made unilaterally (such as in the automotive sector). Weyand stated that all indications are that China's economic policy is moving away from market openness (Weyand, 2021b). A January 2020 report by BusinessEurope reflects similar concerns that China; is consolidating its state-led economy through plans like 'Made in China 2025' and 'Dual Circulation', is re-introducing political ideology in its economy through its 'corporate social credit system' and is exporting its domestic policy mix (BusinessEurope, 2020). These are likely the issues Weyand was referring to. European businesses, and particularly German carmakers, would certainly not want to lose the freedom of ownership and action they have acquired on the Chinese market.

Furthermore, the CAI makes an important start in filling a critical hole in the WTO rulebook regarding subsidy transparency (Hillman, 2021). The WTO already has rules on how to deal with subsidies, but a missing aspect is getting the information about the degree of subsidization, which the CAI for the services sector, expressly arranges and enforces. Once the WTO rules get updated, the CAI automatically subsumes those new rules (Section III, Sub-section 2 Article 8(8)). Hence, it also addressing shirking in relation to existing loopholes that negatively impact the EU's competitiveness opposite China.

In short, H4 is fully supported by the data, the CAI would prevent any retrocession on China's part regarding market access commitments, integrating it into the rules-based international order. A point of criticism may be the lack of enforcement and lack of ISDS. There is still SSDS and it must be stated that there has only ever been one ISDS case brought by an EU company against China – *Hela Schwarz v. China* in 2017 – mainly because of fears of retaliation by the state (Grieger, 2020).

Another aspect which is crucially important to consider is the attitude of the Chinese government in the final month of negotiations. These neo-mercantilist hypotheses have laid out plausible reasons for why the EU decided to negotiate and conclude the CAI. However, in order to answer why the EU decided to conclude it now, in spite of its defensive actions, we must also understand the pressure coming from China. China was determined in the final month to conclude an agreement with the EU in order to get a major symbolic political victory before the Biden administration came into office. The US had waged a trade war with China for years under President Trump, attempting to isolate China. President-elect Biden at the time was clear he wanted rapprochement with America's European allies to address the China challenge (Sullivan, 2020). China wanted to demonstrate it could drive a wedge between the US and EU and show that it could strike agreements with major trade partners, therefore China put significant pressure on the EU (Cheng, 2020; Wuttke, 2020). Although there is only limited data available today to support this claim, the researcher expects future publications to reflect this educated assumption. The EU on the other hand was not inclined to wait for the Biden administration, saying that the US did not consult the EU regarding the Phase One deal which negatively impacted the EU (Wuttke, 2020; Weyand, 2021b; Chen, 2021). Thus, the EU concluded the CAI to rebalance relations with the EU and at the same time reach parity with what the US had gotten through the Phase One deal, in order to allow the US and EU to approach China on a similar level.

Liberal Institutionalism

H1: creating a positive feedback loop

Concluding a complex agreement shows partners are willing to compromise and capable of building on progress. The analysis has shown that, initially, both sides aimed for the investment agreement to be a steppingstone to an EU-China FTA (European Commission, 2013c). This demonstrates original intent of the CAI, if successful, as a key element allowing for a self-reinforcing feedback loop in trade relations. Whereas China has continued to harbour the desire to start negotiations on an FTA, the EU has slowly backtracked and abandoned the idea (Wu, 2021). Earlier this year DG Weyand remarked that “there is no chance we would be able to conclude an FTA with China that would work for the EU” (Weyand, 2021a). Nevertheless, the research demonstrates that the CAI is in significant part motivated by the desire to allow for the pragmatic continuation of trade and investment for mutual benefit under more favourable conditions for the EU. The EU has referred to the CAI as essential to ‘rebalance’ economic relations, given the uneven market access. This could explain the decision by the EU to conclude the CAI despite not completing negotiations on investment protection, which is already incorporated in the existing BITs. Since market access and level playing field issues would be significantly more important if the priority is balancing economic relations so that EU businesses benefit more from bilateral trade and investment. This sentiment is supported by the fact that the EU’s largest investors in China: Germany, France, the Netherlands and Belgium, all have BITs that are post-1998 and thus of higher quality with limited NT, FET and ISDS (UNCTAD, 2021). Each of these countries has large economic interests in maintaining pragmatic trade and investment relations with China. Most of all Germany, as was previously shown. Hence, the EU has chosen to distance itself from the American approach regarding China that started under the Trump administration and is typically summed up as ‘decoupling’.

Both sides have allowed each other the policy space to protect their markets against unwanted acquisitions or competition distorting effects. As stated earlier, the EU has pressed forward throughout 2020 and into 2021 with the proposals of various trade defence instruments. China, on its part, also instated new National Security Rules for foreign investment on December 19th 2020. Although the National Development and Reform Commission (NDRC) explicitly stated its intent was not protectionist, tightening controls was regarded as necessary in order to prepare for new rounds of opening up (NDRC, 2020). The EU was non-respondent to the new rules. Similarly, when Foreign Ministry spokesperson Zhao Lijian was asked about

the EU's proposed foreign subsidy regulation Zhao passed on criticizing the EU and instead claimed unawareness, referring to competent authorities for comment (Lau, 2021).

Thus, the EU and China both want to continue their close economic ties. China because it fears becoming isolated under US pressure, and the EU because it feels the necessity to be pragmatic, work to make progress in bilateral relations and avoid economic obsolescence in the face of a rising East. The recently concluded RCEP plays a role, but also the two years old Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). CPTPP is a high standard trade agreement between eleven countries that includes very detailed chapters on SOEs and IPR (Green, 2021). China has signalled it wants to join CPTPP, in May of 2020 by Premier Li, and again by President Xi at the APEC summit late November 2020 (Global Times, 2020). Together, RCEP and CPTPP could significantly increase regional economic integration in the Asia-Pacific, with the EU locked out, which has led concerns among business associations (VDMA, 2020; BDI, 2020c; Wuttke, 2021). Therefore, the EU has utilized the CAI to bind China into the rules-based international order and try to prevent a bifurcation of the international economic system, which would hurt European businesses (Barkin, 2021). Coming into Germany's Council Presidency they prioritized fostering an effective European Union for a rules-based international order (Eu2020.de, 2020). Afterwards, the CAI was listed as an accomplishment and proof of an EU that is capable of upholding the rules-based international order (Eu2020.de, 2021, p. 14). Lastly, under Section IV the CAI provides many avenues for future dialogue and cooperation in working groups, it is stated in the agreement that the CAI "shall be an integral part of the overall bilateral relations as governed by the Trade and Economic Cooperation Agreement or a future Framework Agreement" (Section IV Sub-section 2 Article 15(2)). Although an FTA is ruled out by the EU for now, a future Framework Agreement is explicitly regarded as the next step. Thus, on the basis of the EU's original intent, newly created institutional mechanisms of cooperation, a potential future Framework Agreement and the desire to bind China in the rules-based international order for a mutually-beneficial and pragmatic continuation of trade relations, H1 of liberal institutionalism is supported by the research.

H2: ameliorating collective action problems and prospective benefits

Although an agreement can have immediate tangible benefits at the moment of entry into force, there are also prospective benefits that the CAI could offer which add up over time. There are

a number of ways in which the EU recognizes the CAI as valuable in that exact sense. Firstly, the CAI contains a ratcheting clause which ensures that future openings by China are automatically conferred to EU businesses (Weyand, 2021a). Secondly, the CAI addresses some longstanding level playing field issues that the EU and other advanced economies have had with China, regarding subsidy transparency, SOEs and forced technology transfers.

The US, EU and Japan have worked together for a number of years in trilateral meetings to address the gaps in the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) (European Commission, 2020b). The three parties had come to an agreement on addressing the issue of subsidies but disagreed on the approach. The USTR did not believe China could be disciplined at the WTO and so the US negotiated bilaterally with China and enforced unilaterally through the Phase One deal (TradeTalks, 2021). Weyand expressed regret that; "the Trump administration used the leverage it created with illegal punitive tariffs on China and wasted it on purchasing commitments on agricultural products, to the detriment of the EU, rather than addressing the systemic issues" (Weyand, 2021a). Instead, the EU envisions utilizing the progress made on subsidies, SOEs and forced technology transfer to move forward and reform the WTO in order to create multilateral protection and safeguards against unfair competition. The Commission will thus work to ensure competitive neutrality (between state-owned and private companies) in the WTO rulebook (Weyand, 2021b). Weyand praised cooperation in the trilateral for establishing the conditions that led to China committing to a ban on forced technology transfers (Weyand, 2021a). Lastly, Weyand noted that the CAI is for the Commission a building block for the "rules-based regulation of globalization", and a springboard to tackle China with partners at the next WTO ministerial meeting (Weyand, 2021b).

The CAI may be weak in terms of enforcement, but it does commit China to practices of notification and consultation regarding subsidies, which has been the main problem (Hillman, 2021). As such, a large collective action problem in terms of a lack of access to private information will potentially be resolved at the WTO through the CAI. Once the WTO rules are updated, CAI automatically assumes the changes. The prospective long-term benefits would entail a rules-based international economic order which is much more apt at addressing the challenges of China's state-led economy and levelling the playing field for EU businesses. Such progress could not be achieved with a defensive strategy alone, which tackled Chinese companies in the Single Market as opposed to more effective behind-the-border reforms in China. Therefore, this hypothesis is definitively supported.

H3: maintaining consistency with previous BITs

Nearly all EU member states already have legal obligations with China regarding investment, since the EU has acquired competency of foreign investment the CAI may be a necessary means to maintain consistency with these existing BITs on a supranational level. A critical point is the fact that the CAI fails to replace the existing 25 BITs between China and the EU. Rather, the CAI reconfirms the potency of the existing BITs stating that there are “not superseded or terminated by this Agreement” (Section IV Sub-section 2 Article 15(1)). Therefore, it also seems that if the CAI appears to be contradicting any existing BIT, that the BIT takes precedence. Analysis has not found any indication that the consideration for the content of the existing BITs has played any role in the negotiations or concluding the CAI apart from the desire to elevate standards of protection and access in China. Although the CAI improves upon existing BITs, the EU had the initial desire to take control over its newly acquired investment competency through the Lisbon Treaty, with a uniform investment treaty with China (European Commission, 2010).

The 2013 impact assessment from the EC that asked the European Council to authorize negotiations with China did expressly refer to the patchwork of BITs as a problem since it led to an uneven playing field between investors from different member states (European Commission, 2013a). Here the research finds another point which credibly explains the prioritization of market access over investment protection by the EU in the CAI. Investment protection was already assured, market access was uneven and thus remedied by the CAI. The document does mention the following: “It should also be considered that BITs are not concluded for an indeterminate period of time. Of the existing 25 BITs, 10 could cease to offer protection before 2023 if terminated by one of the parties” (European Commission, 2013a, p. 16). Therefore, there would certainly still be the impetus for the EU to conclude an agreement on investment protection, 2023 somewhat coincides with the commitment to agree on ISDS two years after signing the CAI (European Commission, 2020c).

In conclusion, there is no evidence that the existing BITs played a critical role in the conclusion of the CAI. The new agreement expands beyond the scope of the BITs but does not supersede or undermine them. It mainly elevates existing standards of treatment and access, beyond the standards of post-1998 BITs and with new components. These new elements and the lack of investment protection in the CAI constitutes a clear divergence from prior BITs. There is no record of EU politicians speaking of CAI in line with what would be expected for

this hypothesis. Rather, the CAI is referred to as a ‘sui generis’ investment agreement, unique and therefore separate from BITs.

H4: maintaining credibility of the global investment regime

Looking from a global perspective, the EU may have been influenced by a vision of the CAI as a device to uphold the credibility of the existing global investment regime. A BIT between China and the EU, two of the largest economic blocs in the world, is of enormous symbolic value as well. It is clear that the global investment regime is currently in a crisis, developing countries are questioning the value and need of these treaties that threaten their sovereignty through lawsuits from multinational corporations (Cervantes-Knox & Thomas, 2017). Ecuador, Bolivia, India, South-Africa and Indonesia have terminated some or all of their BITs in recent years. Moreover, research has shown that terminating BITs has not led to a decrease in investment flows to these countries but rather an increase (Public Citizen, 2018). That runs counter to the commonly held belief that BITs provide the needed legal certainty so that FDI can proliferate. These events and findings are an affront to the existing global investment regime, which first began with a BIT between Germany and Pakistan in 1959 (UNCTAD, 2000). The EU is well aware of its importance for the global investment regime and considers itself a rule-maker and founder of the global investment regime: “The EU is best placed — and has a special responsibility — to lead the reform of the global investment regime, as its founder and main actor” (European Commission, 2015, p. 21).

It is unclear whether the EU has reinvigorated the global investment regime with the CAI, or if they had intended to. The research does reveal a number of aspects which show how the CAI responds to novel challenges in the global economy. Firstly, the CAI proposes a new standard for BITs by also including a section on sustainable development, thereby elevating the status of labour rights, corporate social responsibility and climate action. It marks the first time that China binds itself to sustainable development commitments and is therefore very significant. Secondly, the CAI breaks ground in terms of level playing field with subsidy transparency, SOE disciplines and banning forced technology transfer, as mentioned earlier. Thirdly, the EU itself has described the CAI as a ‘sui generis’ investment agreement, as different from both FTAs and BITs by coupling market access with investment rights (Weyand, 2021a). The CAI could pave the way for a new generation of BITs that liberalizes investment in goods and services. Lastly, the Phase One deal with its purchasing commitments and exclusive access

violated WTO rules and undermined the global investment regime (Chowdhry & Felbermayr, 2020). In important ways the CAI restores the relevance of the rules-based international order by extracting similar commitments from China, but this time in line with WTO rules, such as on an MFN basis for the services sector.

Thus, the CAI does fulfil a function in terms of restoring the credibility of the global investment regime, through new aspects which revitalize the meaning of a BIT. In terms of ISDS, the CAI remains ambivalent and the EU failed to get an agreement which includes their reformed ICS. However, as China is increasingly a capital-exporter itself, it will remain interested in investment protection in an increasingly defensive EU and both sides agree that the status-quo is untenable and work towards multilateral progress. Thus, the research found evidence that the EU considers itself a rule-maker and founder of the global investment regime. The CAI is in many ways an answer to the challenges facing the global regime that emerged in the past decade and regains degree of significance for investment treaties. Hence, the hypothesis is supported by the research.

The table below sums up the empirically informed assessment of each hypothesis.

Table 1	HYPOTHESIS	SUPPORTED	REJECTED
<i>Neo-Mercantilism</i>	1: maintaining the EU's relative competitive position	✓	
	2: ensuring a first-mover advantage		✗
	3: facilitating contradicting interests rooted in heterogeneous competitiveness		✗
	4: pre-emptively countering shirking behaviour	✓	
<i>Liberal Institutionalism</i>	1: creating a positive feedback loop	✓	
	2: ameliorating collective action problems and prospective benefits	✓	
	3: maintaining consistency with previous BITs		✗
	4: maintaining credibility of the global investment regime	✓	

Conclusion and Discussion

This thesis has analysed the development of the Comprehensive Agreement on Investment (CAI) between the EU and China. The research has attempted to find an explanation for the conclusion of the agreement by the EU, in the final hours of 2020, in the face of internal and external pressure to hold off on it. Crucially, the EU has simultaneously developed trade defence instruments that constitute a defensive investment strategy which take aim at Chinese economic practices and directly contradict the collaborative efforts of the CAI. Through process-tracing, combined with document analysis and data triangulation, this thesis has examined the empirical record by utilizing two contrasting theories in order to answer the central research question:

Why did the EU proceed with concluding the Comprehensive Agreement on Investment despite the growing distrust within the EU towards China?

As we assess the theoretical expectations and analysis in order to render judgement on the contrasting theories, the research finds that not all hypotheses from either theory are supported by the empirical record. Neither neo-mercantilism nor liberal institutionalism have been found to be fully accurate in predicting the underlying factors that explain the choice of an offensive investment strategy of the EU in addition to the simultaneous development of a defensive strategy. Nevertheless, the research has provided valuable insights that will aid in the final formulation of a minimally sufficient explanation. Abductive reasoning shows its value as we assess the relative usefulness of each theory. The thesis rejected the official explanation by the EU for concluding the agreement, namely that the negotiating mandate had been fulfilled, and instead offers an alternative account of the decision-making in late 2020.

Both theories share similar foundations in the sense that both take the capitalist system as a given and consider the international arena to be anarchic. Be that as it may, the two theories do provide intriguing insights based on their diverging focus; where neo-mercantilism emphasizes the relative position of a state in the international system and liberal institutionalism the conditions of cooperation and the role of international regimes and institutions. Looking at the hypotheses, liberal institutionalism has been validated on all but one hypothesis. This theory would thus conceive of the CAI as a pragmatic decision by the EU to continue a constructive economic relationship with China and expand the range of possibilities for businesses in both countries through high-level dialogues. Furthermore, the CAI addresses the lack of information particularly with regards to subsidies and allows for

future progress at the WTO, which opens up the potential for competition on fairer terms in China for EU businesses, but also beyond China. Lastly, the CAI would be an important milestone that demonstrates the continuing value of the global investment regime, of which the EU is the founder and an important rule-maker, by addressing novel challenges in the global economy that no BIT has done before. These insights are relevant but in the view of the researcher not sufficient in terms of answering the central research question. They do not explain the degree of urgency that was surrounded by the conclusion of the CAI at the end of the German Council presidency or why the EU simultaneously and unilaterally developed trade defence instruments. It ignores fundamental aspects of EU decision-making that the research uncovered, related to the importance of the interests of big EU corporations in China and the broader developments in the global economy through the actions of other states.

Therefore, we turn once again towards neo-mercantilism and its explanatory narrative. Not all hypotheses have been validated by the research, however, by slightly adapting the hypotheses we can reach a sufficient mechanism that is fully supported by the empirical record. Although there was no evidence that the EU was looking to acquire a first-mover advantage through the CAI, the opposite has been supported by the research. As other major trading partners of China had already benefitted from improved standards of treatment, the EU was looking to match those other states, and in particular the US, which the CAI achieved. Secondly, even though the research could not find evidence that the defensive investment strategy shields uncompetitive businesses from Chinese competitors, the other half of the hypothesis regarding boosting EU corporations in China certainly proved to be accurate. Through statements, documents and the content of the CAI it has become clear that the EU was guided in its actions and negotiations by the interests of its top manufacturers in the largest consumer market in the world. German Chancellor Merkel was found to have had an important role as a key bridge between those (mostly German) manufacturers and the EU's decision-making institutions. Furthermore, the research showed that the EU was concerned with maintaining relevancy in the global economy by safeguarding its presence in China, the engine of growth in the region. That way, European businesses can also benefit from the trade harmonization provisions in RCEP, through their domicile in China serving as a bridge to the entire Asia Pacific region. The EU was demonstrated to have been clearly concerned with a potential rollback in protection and market access in China due to an increase in political ideology in private enterprise. The CAI ensures that the openings China has made unilaterally

cannot be undone unilaterally and therefore deter any shirking behaviour through an international treaty.

Hence, neo-mercantilism is better equipped in responding to why CAI had been concluded in spite of internal pressure due to, for example, concerns about China's treatment of Uighurs or external pressure from the incoming Biden administration. The EU had a geo-economic interest to peg itself to the growth of the Asia Pacific region, boost competitiveness of its top performing business interests in the largest consumer market, and reach parity with the US in order to not be economically disadvantaged and potentially confront China as equals. In terms of the simultaneous defensive investment strategy and its trade defence instruments, through neo-mercantilism we can understand those actions as a pre-emptive move by the EU to restrict uncompetitive behaviour by Chinese firms and disincentivize unproductive M&As that threaten European high-tech industries and has represented the bulk of Chinese investment in the EU. Thus, neo-mercantilism provides a useful prism which views FDI as a global competition with geopolitical calculations and consequences. The theory has offered a strong explanatory narrative supported by the empirical findings, rightly emphasizing dominant business interests, relative power considerations and distrust to explain the choice by the EU of an offensive investment strategy in addition to a defensive investment strategy in the form of concluding the CAI at a conspicuous timing. Lastly, it sufficiently explains Chinese pressure for concluding the agreement as a strategic decision to not be isolated by the US in the international economic system.

There are certain limitations to the thesis both in terms of the nature of the theories and the findings of the research. Firstly, since both theories take the capitalist system as a given there is no room for critically evaluating the undercurrents of the interests of transnational capital and the domestic conditions in both the EU and China. Secondly, the research is reliant on publicly available material and although even frequently omitted material has been considered, it is still dependent on the information the source chooses to share and the manner in which they present, in accordance with their interests. The research has done its utmost to account for those inherent biases through data triangulation. Lastly, considering that the events described are still relatively recent, new information may come to light regarding the dynamics of negotiations.

Since this thesis has mostly focused on the EU's decision-making and its interests throughout the process of concluding the CAI, future research into the Chinese position and its development would be interesting to complement the findings laid out here.

As well as looking into the EU Industrial Strategy and China's Dual Circulation strategy and their implications for FDI. Moreover, locating CAI in the context of the EU's recent changes to the common commercial policy would be worthwhile, through a comparative analysis alongside the recent EU-Mercosur FTA and CETA. Finally, it would be interesting to investigate the degree to which associations and businesses successfully lobby their national government, particularly when it is the President of the Council of the EU, as opposed to supranational bodies like the EC or EP.

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