UNIVERSITÄT TRIER

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***Towards a Geopoliticization of Investment Policy? The Case of EU Investment Screening***

*Paper for the EUSA Biannual Conference Miami, May 2022*

***Very first draft: Please do not cite or quote!***

*Keywords:* FDI; Investment Screening; European Union; Economic Interests, Security Interests; Geopoliticization

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***Abstract***

Facing an ever more competitive China, an economic competitor, and systemic rival, the European Union enlarged its toolbox to deal with the challenge represented by a non-market economy and an authoritarian state, ever more repressive internally and ever more assertive externally. In March 2019, the EU adopted an investment screening framework regulation to coordinate investment screening policies and in order to define criteria, based on which its member states can block Chinese FDI due to security and public order concerns in a number of areas, including critical infrastructure. The paper analyses whether this policy change originated in a changing perception of longer-term European economic interests when facing increased high-tech competition and might reflect domestic demands for protectionism from private actors. Or was it rather driven by growing security concerns of public actors reflecting a more geopolitical interpretation and framing of EU-China economic relations?

Germany, a key destination of surging Chinese FDI in the EU between 2010 and 2016, had a pivotal role as an agenda-setter and driver of this EU policy change. Hence, the paper puts a special emphasis on disentangling economic and security interests as explanatory factors accounting for preference formation and change in Berlin.

> 'As regards China: We cannot disentangle economic and geopolitical questions'
> (Annalena Baarbock, German Foreign Minister)[1]

## Introduction

In recent years, we could observe an international trend towards more intensive control and screening of FDI in many Western states. Even though the new or reformed screening laws apply to every country, these policy changes mainly targeted Chinese FDI. In the EU, too, we observed changes in legislation both at the national and at the European level. In March 2019, the EU adopted a regulation establishing a framework for the screening of foreign direct investments into the Union. It pursues the goal of coordinating investment screening policies to define criteria based on which its member states can block FDI due to security and public order concerns in a number of areas, including critical infrastructure. Thereby, the European Union enlarged its toolbox to deal with the challenge represented by the Chinese non-market economy and its authoritarian state, ever more repressive internally and ever more assertive externally. The paper analyses whether this policy change originated in a changing perception of longer-term European economic interests when facing increased high-tech competition and might reflect domestic demands for protectionism from private actors or rather in a changing perception of security risks and challenges. To put it differently: Can we interpret this policy change as a case of a declining power turning towards economic nationalism and protectionism when facing a dynamic rising economic power? Or is it rather an instance of a process of geopolitization of the bilateral relationship with security concerns and interests gaining in importance and potentially outweighing economic interest?

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[1] Drei Fragen an Annalena Baerbock. In: Internationale Politik Mai-Juni 2022, p. 8 (my translation).

As there is a bidirectional interaction between policy change at the national and at the European level, the paper does not only consider EU-level policy change. Germany, a key destination of surging Chinese FDI in the EU between 2010 and 2016, had a pivotal role as an agenda-setter and driver of this EU policy change. Hence, the paper puts a special emphasis on disentangling economic and security interests as explanatory factors accounting for preference formation and change in Berlin.

The paper proceeds as follows. The following section clarifies the empirical implications of a geopolitical turn of investment policy, which empirical indicators would support an interpretation of a geopoliticization of the EU's investment screening policy, and which observable implications would rather point to a narrower economic rationale of policy change? The empirical sections first look at the agenda-setting and the drivers of policy change at the European level and then at some examples of screening decisions in Germany, which can shed some light on underlying rationales of investment screening and national-level legislative changes in this policy field. The last section concludes.

## Geopoliticization of investment policy

Meunier and Mickus define geopoliticization as the 'reframing of a policy issue as a geopolitical problem' (Meunier and Mickus 2020, 1081). Meunier and Nicolaïdis (2019, 107) refer to geopoliticization 'in a strategic sense, to characterize the external face of economic statecraft whereby trade policies come to be embedded in power rivalries'. Security interest gain in importance when evaluating investment relations with other countries. A geopolitical framing implies that policy-makers distinguish between different countries of origin of FDI investing in their country as some countries are different, China being one of them (Meunier 2014a). Security concerns regarding FDI from different countries of origin are not randomly distributed.

Geopolitical security concerns can take different forms. A growing concern of policy-makers with relative instead of absolute welfare gains from economic exchange would clearly indicate a framing of the bilateral economic and investment relations in terms of a longer-term power struggle. Furthermore, security concerns could relate to the capacity of the other side to weaponize economic interdependence and to cause disruptive shocks, using economic means to pursue geopolitical ends (Farrell and Abraham 2019; Drezner et al. 2021). Geopoliticization of a bilateral investment relationship not only entails its reframing as a geopolitical problem. It also entails the politicization of the bilateral relationship. This implies higher public visibility, a higher degree of controversy surrounding the issue, and a growing number of actors taking part in the debate (Grande and Hutter 2016).

According to Kirshner (1998, 66), 'it is difficult to disentangle the political and economic objectives of states' as there is an 'underlying long-run harmony between the national pursuit of wealth and power'. The two are deeply enmeshed. In our specific field of investment control, Lenihan (2018) analyses investment screening as a tool of statecraft

to defend or improve one's own economic and military capabilities in order to internally balance potential external threats.

Investment screening is then part of a longer-term security policy. But in the shorter run, security and economic objectives might stand in contradiction to each other. How, then, can we disentangle economic from security concerns and interests when trying to identify key explanatory factors driving policy change? We can make use of the following indicators to identify a prevalence of geopolitical over economic interests as drivers of policy change in investment policy.

*First*, the reframing of investment relations and FDI as a geopolitical concern should be embedded in and preceded by a broader process of geopolitical reframing economic relations, specifically with China, as it seems to differ from the rest of the world. *Second*, the agenda for policy change should be set by public actors, not by private economic actors and their interest groups asking for protection from rival foreign companies. *Third*, agenda-setting by actors from directly security-related ministries, such as defence and home affairs, and the related policy networks and not (only) by actors from ministries for the economy and finance would provide even more convincing empirical evidence regarding the underlying geopolitical interests and concerns. *Fourth*, do actors advocating FDI screening articulate security concerns when providing a rationale for legislative change? Of course, security-related arguments might only provide a smokescreen hiding economic interests as mundane material interests might be considered less defensible than security interests for either political or legal reasons. Therefore, we look, *fifth*, at the way how broadly security interests are defined. A long and vague list of security concerns and related criteria used to vet FDI would lend support to the idea that they are merely used as a pretext to advocate protectionist policies and to prevent rival economic firms from acquiring valuable assets and technology. *Sixth*, do we observe a changing time horizon of decision-makers, emphasizing long-term economic and security implications of Chinese FDI more than short-term economic gains? According to Meunier (2019, 355), 'the main concerns [in Europe] are less about direct threats to national security than about the long-term implications for the economic competitiveness of the host country if China acquires technology'. And is the link being made between longer-term competitive disadvantages of a continuing sell-out of valuable assets and the way they might feed into Chinese material power resources of China that might be used against the EU in the future?

These indicators mainly relate to agenda-setting, political legitimation of policy changes, and the concrete content of legislation in terms of criteria for evaluating and potentially blocking FDIs. Beyond this, we can analyse how individual EU member states use their national FDI screening mechanisms. Do screening practices provide further evidence on underlying geopolitical concerns and interests? The following indicators would support the hypothesis of a growing geopoliticization of FDI policies. *Seventh*, we would find examples of governments blocking acquisitions on security grounds, even in cases the European company has to face economic losses as a consequence of a blocked Chinese investment. *Eight,* a geopolitical explanation is more convincing in case the blocked investments have a clear link to the production of directly defence-related dual-use goods

and to critical infrastructure, the control of which might provide the Chinese party-state with an option to cause heavy disruptions and economic havoc when pursuing its geopolitical strategies. Table 1 summarizes the empirical indicators pointing to geopolitical concerns underlying policy reforms and policy implementation.

The politicization dimension of the geopoliticization of investment relations can be assessed by looking at the salience of and controversies surrounding EU-Chinese investment relations in general and specific cases of mergers and acquisitions in particular.

Table 1: Indicators of a geopoliticization of Chinese FDIs in the EU

| | |
|---|---|
| 1. | Geopolitical framing of EU-China investment relations embedded in and preceded by broader geopolitical framing of EU-China economic relations. |
| 2. | Agenda-setting by public actors, not by private actors. |
| 3. | Agenda-setting by security-related institutions. |
| 4. | Decision-makers articulate security concerns in order to make the case for investment screening. |
| 5. | Criteria used to evaluate and vet investments are well-defined, concise, and narrowly security-related. |
| 6. | Time horizons of decision-makers are getting longer as longer-term power resources implications of FDI gain in importance. |
| 7. | FDI by Chinese state-owned or controlled enterprises raise particular security concerns. |
| 8. | Governments block acquisitions on security grounds, even when if the European company has to face economic losses as a consequence of these decisions. |
| 9. | Decisions to block Chinese FDI mainly relate to the defense sector, dual-use goods, and critical infrastructures. |
| 10. | Chinese FDIs and the European regulatory response to them gain political salience beyond the narrow policy networks dealing with investment relations. |

## Geopoliticization of problem framing

When comparing basic policy documents on the EU's strategic relationship with China over time, a change in the broader discourse on economic relations with China is all too obvious. In their joint communication to the European Parliament, the European Council and the Council of March 2019, the Commission and the EU's High Representative for Foreign Affairs and Security Policy dealt with China as being 'simultaneously, in different policy areas, a cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with whom the EU needs to find a balance of interests, an economic

competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance' (European Commission/High Representative 2019, 2).

This type of discourse, emphasizing the need for more fairness, for a level playing field and reciprocity in market openness for both trade and investment, and advocating a more 'robust' trade policy approach towards China based on 'clearly defined interests and principles' (European Commission/High Representative 2019, 1), increasingly pervades official EU documents. This change in the way EU policy-makers perceive China, its economic model and its trade policy occurred in the 2010s, mainly between 2013 and 2016, after the political and economic change under the new leadership of Xi Jinping became clearer. Whereas earlier policy papers from the 1990s and early 2000s stressed the opportunities and the potential of the partnership, the latest 'strategic outlook' from 2019 bluntly stated that 'there is a growing appreciation in Europe that the balance of challenges and opportunities presented by China has shifted' (European Commission / High Representative 2019, 1).

This might be interpreted as simply reflecting an economic frame through which the bilateral economic relationship with China is perceived. However, geopolitical language increasingly entered EU policy documents on China.

In its 2021 Trade Policy Review, the Commission stressed the concept of 'open strategic autonomy'. Open strategic autonomy

> emphasises the EU's ability to make its own choices and shape the world around it through leadership and engagement, reflecting its strategic interests and values (…). It further signifies that the EU continues to reap the benefits of international opportunities, while assertively defending its interests, protecting the EU's economy from unfair trade practices and ensuring a level playing field (European Commission 2021, 4).

This policy document expresses the EU's continuing 'support for effective rules-based multilateralism (which) is a key geopolitical EU interest', and stresses its contribution to the provision of global public goods such as an open international economic order. More than in the past, however, it stresses the 'well-understood self-interest' and the need 'to equip itself with tools to operate in a more hostile international environment if necessary'. To civilize this more 'hostile international environment', '(b)uilding a fairer and rules-based economic relationship with China is a priority' (European Commission 2021, 4, 8, 9). The perception indeed gained ground that the EU has to deal with a competitor

pursuing a geo-economic strategy and 'with whom free competition is for some reason a losing game' (Luttwak 1999, 137).

Not only did the references to unfair trade practices and the lack of reciprocity in trade and investment relations gain in importance. So did the self-description of the EU's trade policy as pursuing 'a further EU policy shift towards a more realistic, assertive, and multi-faceted approach' (European Commission / High Representative 2019, 1). In its 2019 strategic outlook, the Commission and the High Representative dealt with China for the first time as a potential security threat for the EU and not only as a potential partner for dealing with security challenges in other parts of the world. This security threat perception related to Chinese investments in areas of critical infrastructure 'such as 5G networks that will be essential for our future and need to be fully secure' (European Commission/High Representative 2019, 9). Furthermore, this document stressed the security threat the EU faces due to the Chinese military build-up:

> China's increasing military capabilities coupled with its comprehensive vision and ambition to have the technologically most advanced armed forces by 2050 present security issues for the EU, already in a short to mid-term perspective. Cross-sectoral hybrid threats including information operations, and large military exercises not only undermine trust, but also challenge the EU's security and must be addressed in the context of our mutual relationship (European Commission / High Representative 2019, 4).

This provides an example for a long time horizon of European policy-makers dealing with the economic and security challenges emanating from China. The structural power shift towards China and Chinese assertive geopolitical and geo-economic strategies fuel threat perceptions and security concerns in the EU. For sure, security concerns gained in importance, but contrary to the US, they do not provide the key lens through which EU-level policy-makers tend to analyze the EU's bilateral economic relation with China. The economic narrative regarding the unlevel playing field and calls for more reciprocity remains dominant compared to security-related problem perceptions in the EU institutions' discourses and policy documents on its bilateral relation with China.

To sum up: We find evidence of a growing but still limited importance of geopolitical concerns and interests compared to economic concerns and evidence for a longer time horizon of EU policy-makers when defining the strategic relationship with China. This provides a background for a potential geopoliticization of investment-related policies.

## Agenda-Setting

Before adopting the investment screening framework regulation in 2019, the EU had no European-level regime for vetting inbound FDI. It could only make use of its powers in competition policy in case M&A operations entailed the risk to create dominant market positions and thereby to limit competition. The national regimes on investment screening of its member state (as far as they had one) differed substantially. Legal fragmentation prevailed. Furthermore, the member states had bilateral investment treaties with China in place. With the entry into force of the Lisbon Treaty, FDI became part of the common commercial policy, so that the EU gained exclusive competence in this field and was empowered to regulate inbound direct investment, with the exception of portfolio investments (art. 207 TFEU).

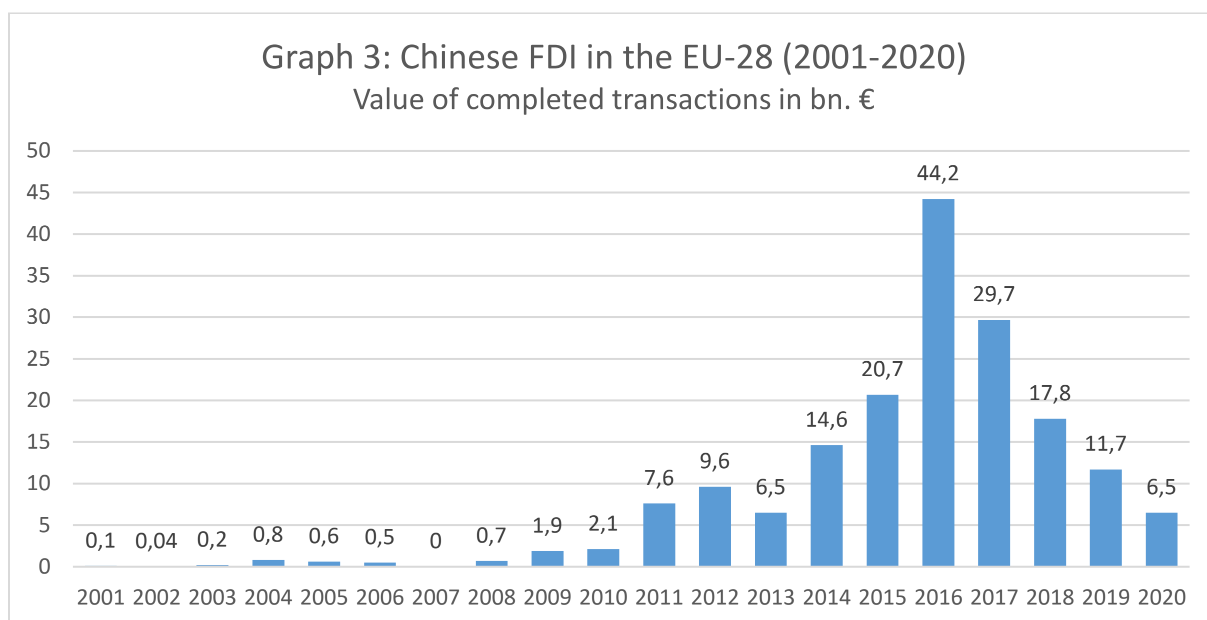
Towards the end of the 2000s, a debate emerged on potential dangers of FDI, in particular regarding the role of sovereign funds, and on the need for EU-level rules (Grieger 2017, 11). The rise of acquisitions by Chinese and Russian Sovereign Wealth funds made the European Council point to 'a limited transparency regarding their investment strategy and objectives' in 2008 and advocate a European approach (quoted after Tan 2021, 32). In 2011, Commission Vice President Tajani and Internal Market Commissioner Barnier made the case for a EU institution to screen foreign FDI, similar to the Committee on Foreign Investment in the United States (CFIUS). Trade Commissioner Karel de Gucht and a majority of Commissioners, however, blocked this initiative. They feared that it would be seen as protectionist and possibly lead to restrictions on European investment in China (Meunier 2014b, 1012). In a resolution adopted in 2012, the European Parliament asked 'the Commission and Member States to set up a body entrusted with the ex-ante evaluation of foreign strategic investment, along the lines of CFIUS, in order to obtain a clear picture of businesses operating and investing in the territory of the EU, and to report to the parliament on a regular basis' (European Parliament 2012).

However, it was not until the mid-2010s that Chinese foreign direct investment (FDI) into Europe became a salient issue. The very low level of stocks and flows from China to the EU (see graph 3) until the late 2000s explains the low salience before the 2010s. Back in 2014, Meunier saw little interest in regulating inbound investment: 'Neither the Commission nor the member states nor business groups seem particularly interested in addressing inbound FDI' (Meunier 2014b, 1009).

Things changed quickly thereafter. A very dynamic growth—an eighteen-fold increase of Chinese FDI in the EU between 2010 and 2016, combined with the strategic choice of Chinese investments changed perceptions. Chinese FDI took more and more the form of mergers and acquisitions (M&A) rather than greenfield investments, which were initially more important. The former provide Chinese companies with access to European technologies, skills, and equipment instead of transferring technology from China to the EU.[2] In 2016, the peak year of Chinese FDI in the EU, the acquisition of advanced manufacturing companies accounted for a third of all Chinese investments in value (Hanemann and Huotari 2017, 5). In Germany, the value of Chinese FDI investments rose almost tenfold from 2015 to 2016 (Meunier 2019, 347). With € 11 bn., these were higher than the past 10 years taken together. Moreover, they increasingly focused on high-tech companies (Stanzel 2017). The steep FDI increase until 2016, the strategic choice of targets, and a number of particularly controversial company takeover bids in critical infrastructure and cutting-edge technology companies such as robotics and the semiconductor industry in 2015 and 2016 sparked broader public debates and media attention. They provided policy-makers with a focusing event. This triggered demands for policy change and opened up a policy window for new legislation on investment screening, both at the national and at the EU level.

Chinese FDIs in the EU, being part of a 'strategy of aggressive investments into Europe's high technology and infrastructure sectors' (Godement 2020, 267), raised a number of concerns. *First*, gaining control of critical network-based infrastructure (telecommunication, electricity, railways) might represent a security risk in times of rising geopolitical competition with China.

[2] On trends of Chinese FDI in Europe, see Hanemann, Huotari and Kratz (2019).




*Source: Kratz, Zenglein and Sebastian (2021): Chinese FDI in Europe: 2020 Update. Rhodium Group and MERICS.*

*Second*, and more importantly, the awareness in the EU grew that these mergers and acquisitions were not market-driven but part of a national industrial policy strategy, in particular the Made in China 2025 program (Gottwald, Schild and Schmidt 2019, 136-138). The stated goal of this policy is to move Chinese companies up the value chain and to create national champions able to gain substantial world market shares, outcompeting their European rivals. 'In research on 336 Chinese acquisitions in the EU from 2005 to 2017, ECFR [European Council on Foreign Relations] has identified 117 cases out of 336 that are directly related to Manufacturing 2025 targets' (Godement and Vasselier 2017, 44; see also Jungbluth 2018). The Commission saw 74% of the Chinese M&A deals in the EU since 2013 as being linked to the 'Made in China 2025' strategy (European Commission 2021c, 44).

In some Member States, the acquisition of high-tech crown jewels by Chinese companies sparked public controversies, providing evidence for a politicization of FDI. This was the case, for instance, when the Chinese Midea Group acquired the German company KUKA in 2016, offering € 4.5 bn., the largest Chinese takeover in Germany. KUKA is a world market leader in industrial robots.

In the same year, China's Fujian Grand Chip Investment Fund made a takeover bid for the systems manufacturer and chip equipment maker Aixtron. This experience triggered two successive changes in the German investment control regime (Außenwirtschaftsverordnung) in the space of only two years, allowing for a more

comprehensive control of FDI even in cases of minority shareholding below the 25 per cent blocking minority threshold in July 2017. In December 2018, the German government lowered this threshold to 10 per cent for FDI in areas related to defence and security-relevant infrastructures (Bundesregierung 2018). In the process of interministerial coordination, the ministry of defence had called for this lower threshold.[3] In 2020, the German government enlarged the circle of economic sectors subject to screenings of investments for security and public order related risks to the health sector (Bundesregierung 2020). Other EU member states have tightened their investment control regime as well since 2017, e.g. Austria, France, Finland, Germany, Hungary, Italy, Latvia, Lithuania, Poland, Romania, and Spain. France, Italy, Latvia and Lithuania, the UK, the Czech Republic, Denmark, Malta, Slovenia, the Slovak Republic introduced one for the first time (European Commission 2021, 9).[4]

*Third*, Chinese investment in critical infrastructure and dual-use technology that might be used for armament production raised geopolitical and security concerns. In the Aixtron case, the Chinese company dropped its bid when the Obama administration blocked the US-related part of the takeover on security grounds following an investigation by CFIUS in December 2016 (FT.com 2016). The German government changed its stance on the issue only thereafter. In a similar case of dual-use technologies, another CFIUS review made the Obama administration block the acquisition of the Dutch lighting company Lumileds by the Chinese Go Scale Capital group in 2016 as its know-how in semiconductor technology could be used for armament production (Meunier 2019, 352).

Against the background of the spike in high tech takeover bids in 2016 and the KUKA and Aixtron case, the German minister for the Economy, Sigmar Gabriel, called in an op-ed for new German and European instruments 'to protect security-relevant technologies'. Particular attention should be given to cases 'in which a state-dominated enterprise links the acquisition of technology to the expansion of its geopolitical power' (Die Welt 2016, our translation). In the past, German actors, both private and public, proved reluctant to support a supranational regime that might endanger the access of its industry to the Chinese market. The change in Germany's position on investment screening had an important impact on the European level.

[3] Interview with a former high-ranking official of the German Ministry of Economics on 9 February 2022.
[4] For a short overview of recent reforms, see Hanemann et al. (2019, 16-17).

The reform idea of adopting a EU-level screening framework legislation only gathered steam when three big member states – France, Germany, and Italy – joined forces to set the agenda for EU-level legislation on investment screening in February 2017. In their common letter, the ministers for the Economy, Michel Sapin, Brigitte Zypries, and Carlo Calenda warned of a 'possible sell-out of European expertise' in key sectors of technological competence to non-EU investors acquiring tech companies for strategic purposes without European companies being allowed reciprocal access to their home market.[5] They successfully launched a debate on EU policy options. At the same time, the presidential candidate Emmanuel Macron repeated long-standing French calls for reciprocity in EU-China economic relations and warned against a 'naïve' EU policy on China. In his electoral manifesto, he called for a European control mechanism to screen third-country FDIs in order to protect strategic sectors of the economy (Macron 2017).

On 24 March 2017, members of the European Peoples' Party (EPP) group at the European Parliament led by Manfred Weber submitted a proposal for a Union Act on the screening of foreign investment in strategic sectors in order to avoid potential 'significant damage to the EU economy, in particular, in areas sensitive to security and industrial policy'. It asked for the extension of existing protections to strategic sectors such as energy, health, telecommunication, transport, and water and called for a European Committee on Foreign Investment, having the example of the US CFIUS in mind (Grieger 2019).

In a common non-paper from July 2017, France, Germany, and Italy explained their ideas in more detail,[6] and in August 2017, the German minister for the economy, Brigitte Zypries, addressed a letter to the Commission president Jean-Claude Juncker and exhorted the Commission to take action. She pointed to the 'one sided concentration of [Chinese] investments in industrial high tech and key technology companies with clear links to the China 2025 strategy adopted by the Chinese government' and underlined the investment restrictions in the Chinese market: 'Open markets cannot be a one-way street' (Zypries 2017, our translation).

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[5] The letter is documented on the website of the German Bundesministerium für Wirtschaft und Energie: Brigitte Zypries, Michel Sapin, Carlo Calenda: Schreiben an EU-Handelskommissarin Cecilia Malmström, Februar 2017, Available at: https://www.bmwi.de/Redaktion/DE/Downloads/S-T/schreiben-de-fr-it-an-malmstroem.pdf?__blob=publicationFile&v=5 (last accessed: 28.1.2022).

[6] Governments of France, Germany and Italy: European investment policy: A common approach to investment control, 28. July 2017, available at: https://g8fip1kplyr33r3krz5b97d1-wpengine.netdna-ssl.com/wp-content/uploads/2017/08/170728_Investment-screening_non-paper.pdf ( last checked : 30.04.2019).

The president of the Commission, Jean-Claude Juncker, seized the ball and announced a legislative proposal in his 2017 State of the Union address on 13 September 2017, published on that same day (Juncker 2017). This proposal took key points mentioned in the Franco-German-Italian paper on board. It limited its ambition to define a European-level legal framework, defining principles, and reporting obligations on national investment screening procedures, without attempting to shift decision-making powers to the European level.

This rather cautious approach adopted by the Commission reflects the constellation of actors and interests it faced. Germany, France, and Italy feared a sell-out of high-tech expertise to Chinese investors and a one-sided technology transfer to China. Chinese companies might acquire technological leadership in key sectors thanks to long-term industrial and technological policy strategies along the lines of the Made in China 2025 program and thanks to abundant state subsidies. Moreover, their participation in takeovers of companies in critical infrastructure, ports (e.g. Piraeus Port in Greece), airports, power grids, and other network-based utilities, might represent a potential security threat. The advocates of change faced a coalition of Northern European member states with liberal and anti-protectionist economic ideas and Southern European member states such as Greece, Portugal, and Spain, eager to attract Chinese infrastructure investments to overcome the economic hardship of the Eurozone crisis. Capital-importing Southern countries wanted the EU to stay open to Chinese investments, and some capital-exporting Northern countries feared Chinese retaliation in case of investment restrictions. This heterogeneous coalition did not go along when the newly elected French President Macron tried to push them towards rapid European steps on investment screening at the European Council meeting in June 2017 (Le Parisien 2017). The liberal-minded UK had reservations as well. Some governments were internally split between advocates of a regime of free capital movements and actors pursuing a security agenda.[7] Chan and Meunier (2021) explain the dividing lines between member states based on differences in their technological expertise. Member states with important high-tech sectors and important Chinese investments in high-tech lent more support to the investment screening reform than countries at lower levels of technology.

What about the private sector? The agenda-setting for investment screening and the political initiative for law-making in that field did not respond to the societal demands of

[7] For an overview on actors' interests and coalitions, see Rasmussen Global (2017, pp. 3-4).

stakeholders in the private sector articulated by business associations. It clearly emanated from the governments of three key member states. Back in 2008, BusinessEurope articulated 'concerns over proposals to create a Committee on Foreign Investment in the United States or CFIUS-type review procedure to vet foreign proposals for mergers and acquisitions' as it found no evidence of politically motivated investments in the context of debates on sovereign wealth fund investment (BusinessEurope 2008, 1). A decade later, it warned 'that the door to protectionism should remain closed', while supporting a 'calibrated, risk-based approach that respects the balance between achieving legitimate security and public order objectives while maintaining an open and welcoming environment for much needed FDI in the EU' (BusinessEurope 2018, 1). Orgalime, a European-level federation representing Europe's technology industries and strong exporters —key targets of Chinese FDI in Europe—saw no 'need for a second layer of investment screening at European level'. It warned that the Commission 'underestimates the negative effects such a legislation would entail in the long run, namely an erosion of companies' freedom to invest in "critical technologies" such as robots, semiconductors, and dual-use goods, leading to an overall decrease of investments in such technologies' (Orgalime 2018, 1). Support came from AEGIS Europe, representing mainly the interests of import-competing sectors. It stressed that 'industries are increasingly faced with third-country government-led acquisitions that erode the integrity of European manufacturing capacity' (AEGIS 2018). The Federation of German Industries (BDI), on its part, had not asked for a change in national law nor for an EU-level investment screening legislation. Quite to the contrary, it saw policy responses both at the German and the EU level as being 'politically motivated' and made clear that 'German industry rejects protectionist measures' infringing upon private property rights of company owners and on the freedom of contract. 'Threats to introduce restrictions on market access for foreign investments do not qualify as suitable means to persuade China to open its markets' (BDI 2018). While supporting in principle the investment screening on security and public order grounds, it came out strongly against an ever-larger understanding of these concerns, repeatedly warned against a 'global spiral of investment protectionism', and rejected the use of investment screening as a tool of industrial policy and as a protective shield for European high tech firms (BDI 2020; see also BDI 2019). Whereas the BDI fully supports the EU's reciprocity discourse and demands in trade, 'German industry rejects reciprocity in the context of direct investments' (BDI 2018). Other important economic interest groups such as the Verband Deutscher Maschinen- und Anlagenbau-VDMA (Association of the

Mechanical Engineering Industry with more than 3400 members) and the Deutscher Industrie- und Handelskammertag-DIHK (Association of German Chambers of Industry and Commerce) published similar skeptical statements. Target companies of Chinese takeover bids did not ask for protection either. In the particular case of the KUKA takeover by the Chinese Midea Group, KUKA's chief executive, Till Reuter, publicly supported the offer, contrary to the workers' representatives on its supervisory board (Chazan 2016; Reuters 2016). So did Georg Kofler, the main owner of Leifeld Investment (Kögler 2018). The company had planned to invest in capacity extension with Chinese capital. The German government vetoed the investment on security grounds (see below). The investment screening proposal found support, however, among the Deutsche Schutzvereinigung für Wertpapierbesitz-DSW, Germany's leading association for private investors with some 30,000 members (Tan 2021, 37-39).

Executive autonomy from private interests proved to be high. On the national level, governments developed their preferences independently and even in opposition to key interest groups. Germany is a case in point as the government's preference change on the topic stood in clear contrast to the position of the most powerful domestic business interest group, the BDI. Longer-term concerns regarding unfair high-tech competition with China and geopolitical security concerns trumped shorter-term business interests.

Economic interest motivated the skepticism and opposition to EU-level investment screening in Southern European member states benefitting from Chinese direct investment in infrastructure. Economic interest in open investment markets also fueled the skepticism of interest groups in member states, the governments of which supported policy change.

What about security concerns? How did they influence the agenda-setting process? Policy-makers invoked security and public order concerns repeatedly to justify the need for an EU-level investment screening legislation. However, they might simply have used these arguments as a smokescreen to hide other concerns, notably protectionist interests in preserving high-tech expertise and brands from being sold out to China. From a legal point of view, security and public order concerns provide the only valid reasons allowing for a restriction of the freedom of capital movement as enshrined in EU primary law.[8] Therefore, it does not come as a big surprise that security concerns figured prominently

[8] Articles 63 and 206 TFEU.

in policy-makers' statements and the Commission's legislative proposal's explanatory memorandum. A conceptual stretching of the notion of 'critical infrastructure' in order to cover a large number of economic sectors, notably high-tech sectors and advanced manufacturing, might follow the same logic of disguising underlying economic interests in protection from current and future Chinese competitors. Furthermore, the French and German ministers for the Economy, Le Maire and Altmaier, spelled out an economic rationale for using the investment screening instrument in their *Franco-German Manifesto for a European industrial policy fit for the 21st Century*: The investment screening framework 'needs to actually be used by the Member States to protect Europe's strategic technologies and assets which are critical' (Bundesministerium für Wirtschaft und Energie and Ministère de l'Économie et des Finances 2019).

**Criteria for vetting inbound FDI**

The FDI screening regulation adopted in February 2019 establishes a cooperation mechanism, both between the member states and between the member states and the Commission, for screening direct investments that could endanger security and public order.[9] The regulation provides a long, non-exhaustive list of criteria based on which competent authorities can screen third-country FDI. However, these criteria remain clearly linked to grounds of security and public order, the only grounds justifying to restrict the freedom of capital movement in the Union's primary law and in the EU's international commitments in the WTO framework and in its trade and investment treaties. Purely economic criteria such as competitive distortions due to public subsidies or general reciprocity demands, as mentioned in the Franco-German-Italian non-paper, did not find their way into the regulation, which sticks to a predefined legal path.

The regulation defines a comprehensive list of factors that member states can use to check third-country FDI projects with regard to their impact on security and public order. This encompasses the FDI's impact on critical infrastructures, 'including energy, transport, water, health, communications, media, data processing or storage, aerospace, defence, electoral or financial infrastructure, and sensitive facilities, as well as land and real estate crucial for the use of such infrastructure' (art. 4(1a)), on critical technologies and dual-use items, 'including artificial intelligence, robotics, semiconductors, cybersecurity,

[9] Portfolio investment is not covered by the regulation, see Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, recital 9.

aerospace, defence, energy storage, quantum, and nuclear technologies as well as nanotechnologies and biotechnologies' (art. 4(1b)), on supply of critical inputs such as raw materials and energy (art. 4(1c), on 'access to sensitive information, including personal data, or the ability to control such information' (art. 4(1d)), and finally, on 'the freedom and pluralism of the media' (art. 4(1e)).

This long list of areas and types of investments that member states can take into account when vetting inbound FDI indeed covers security-related fields both in the narrower sense of dual-use technologies with evident military uses such as aerospace, defence, and nuclear technologies and in the equally security-sensitive field of critical infrastructures the control of which can be abused for causing deep disruptions in economy and society of host states. As the regulation covers broad areas of cutting-edge technologies from quantum computing and artificial intelligence to energy storage, nano- and biotechnologies, the list is, however, fully compatible with an economic interest interpretation of the underlying driving forces.

Concerns about data privacy, electoral infrastructure, and the freedom and pluralism of the media are hardly addressing narrower security interests but rather the defense of a democratic model of individual rights and public freedom and the integrity and proper functioning of the democratic process. They reflect more on the need to address a multitude of concerns when forging a complex compromise package that takes on board the specific demands articulated by the European Parliament.

The screening procedure should take into account whether the investor is directly or indirectly controlled by a government or a state body (art. 4(2a). Here, the shadow of Chinese state-owned enterprises or undertakings with close links to the party-state looms large. This provides us with evidence of a geopoliticization process, as it singles out a particular type of investors that might weaponize economic interdependence to pursue geopolitical goals.

## Practices of investment screening: the German case and beyond

A look at the practice of national investment screening lends support to the assumption that security interests played a major role in getting tougher on investment screening, both at the national and European levels. Security interests regarding Chinese FDI relate to a) gaining control over strategic assets and critical infrastructure (e.g. power plants and grids, ports, railway networks) that might be used for acts of sabotage and disruptions, b)

acquisition of dual-use technology for military build-up (e.g. semiconductors, optical equipment), c) the transfer of technical know-how and armament-related technology to hostile third countries (e.g. North Korea) (Grieger 2017, 5).

Until 2014, no member state had ever blocked Chinese FDI based on its national investment screening regulations (Meunier 2014b, 1012). This changed quickly and profoundly thereafter. Germany, the second most important destination for Chinese FDI in the EU-28 after the UK, provides evidence for this change. A number of German decisions on critical cases of Chinese takeover bids for companies testify to the rising importance of security concerns.[10] When the State Grid Corporation of China (SGCC) made a bid to acquire 20 % of the German high-voltage transmission grid company 50Hertz in 2018, the German government successfully used the public development bank Kreditanstalt für Wiederaufbau (KfW) to buy shares of 50Hertz sold by its former owner in order to block the Chinese participation in its capital.[11] 'Based on security considerations, the German government has a strong interest in protecting the German transmission grid as the core of the German energy supply and classifies the latter therefore as being a critical energy infrastructure' (Bundesregierung 2018, our translation). In the same year, the German federal government was about to veto an attempt by the Chinese Yantai Taihai Corporation to take over the German Leifeld Metal Spinning, a leading tooling machine maker for metal forming. One day ahead of the federal government's cabinet meeting to discuss the matter, Yantai Taihai withdrew its offer. Once again, the government had security concerns as Leifeld technologies and products could be used for enriching uranium and in the aerospace industry and hence for military purposes besides civilian ones (Die Welt 2018). In 2020, the German government blocked the acquisition of PPM Pure Metals, a producer of high-purity metals used in semiconductor and infrared detector production by the Chinese Vital Material Co. PPM, favorable to the deal, supplied the German military and went insolvent, leading to the loss of some 85 jobs (Reuters 2020). According to a press report, the German ministry of defense opposed the deal (Werner 2020). Security concerns clearly trumped economic interests in this case.

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[10] The following paragraph is based on an overview provided by Tan (2021, 34-36).

[11] The German government choose this option as it could not block the Chinese acquisition of 20 percent of 50Hertz's shares. This remained below the 25 percent threshold in force at that time allowing the government to block the Chinese investment.

Likewies, security concerns led the German federal government to veto in 2020 the takeover of IMST, producing satellites and radar technology and supplying the German army, by the state-owned China Aerospace and Industry Corporation's, producing short-range and antiaircraft missiles. In this case, it was the ministry of the economy that articulated security concerns, whereas the German defense ministry 'was however visibly absent' (Tan 2021, 34).

In Belgium, too, we find a case in which security-related institutions raised concerns against Chinese investment. In 2016, the Belgian security services (VSSE) warned against the participation of the Chinese State Grid in the gas and electricity grid operator Eandis. The owners blocked the takeover, but for reasons unrelated to security concerns (Grieger 2017, 7-8).

In March 2022, the Italian government annulled the acquisition of a majority in Alpi Aviation, producing military drones, by Chinese investors in 2018 who failed to inform the Italian government about the transaction. It feared a loss of strategically important knowledge and production capacities. During Draghi's term in office, the government blocked four takeover attempts (Frankfurter Allgemeine Zeitung 2022). Five out of the six takeover attempts blocked since 2012 by the Italian government originated from Chinese companies.

**Summary and Conclusion**

Security concerns regarding inbound FDI from China indeed grew in importance since the middle of the 2010s. Our indicators provide empirical evidence for this. We see indeed elements of a geopolitical framing of Chinese FDI by the EU and national actors. The explicit warning of the former German minister for the Economy Sigmar Gabriel against state-dominated Chinese enterprises pursuing the acquisition of technology to expand China's geopolitical power is a case in point. The special concern about state-owned enterprises is reflected in the text of the EU's framework regulation, as the screening procedure should take into account whether the investor is directly or indirectly controlled by a government or a state body. This provides evidence for the geopoliticization process that singles out a particular type of investors and countries that might weaponize economic interdependence when pursuing their geopolitical goals.

Furthermore, this geopolitical framing of investment screening is embedded in a broader geopolitical discourse on EU-China economic relations. However, the EU and national

policy-makers do not adopt a strategic power competition perspective as their key lens to interpret bilateral relations with China in the way US administrations have done since the 2010s.

Agenda-setting for policy change came from the public, not private actors. Economic interest groups did not advocate a protectionist turn on investment screening but rather warned against rising protectionism. Among the public actors setting the agenda, ministers for the economy were key, not security-related ministries such as defence or home affairs. Public statements of agenda-setting ministers for the economy reflect a growing concern about a sell-out of cutting-edge European technologies to Chinese companies that move up the value chain and could outcompete European companies in the latter's fields of excellence. By pushing for policy change, the French, German, and Italian governments prioritized longer-term protection of key high-tech industries and longer-term economic interests over the short-term interest of cash-strapped European companies interested in Chinese investments. This reflects a longer time horizon. Geopolitical concerns played a minor role in their discourse. For legal reasons, however, the EU-level and national policy-makers had to refer to security and public order concerns, as they provide, according to European primary law, the only justification to limit freedom of capital movements.

The criteria defined in the EU's investment screening regulation do not reflect a narrow security concern. To be sure, they address security risks, notably regarding the control of critical infrastructures and dual-use goods. However, they are quite broadly defined, covering large fields of high-tech sectors. Of course, this could be interpreted as flowing from longer-term concerns about rising Chinese economic power resources to which investment in European high-tech industries can contribute. They are rarely invoked explicitly, though.

Looking at the implementation of investment screening and decisions to block FDI, we find a number of cases testifying to security concerns. This holds true for blocked investments in critical infrastructure such as electricity grids and for blocked investments in closely defence-related technologies and companies. In one case, the German company PPM suffered job losses due to the blocked Chinese investment. This underlines the priority of longer-term security over short-term economic interests in the German government's decision.

On the other side, we found two cases – Aixtron and Lumileds, both active in dual-use semiconductor technology – in which the Obama administration rang the alarm bell, not the German or Dutch government. This provides us with evidence of the higher importance attached to security interests by the US compared to EU member states' governments.

Inbound FDI, investment screening, and legislative changes thereof usually do not spark a broader interest beyond narrow policy-makers networks. The KUKA robotics producer takeover by the Chinese Midea group provides us with a rare example of high politicization, that is high salience, media interests, and public controversies. It was a game-changer. It contributed to turning the German government into an advocate of EU-level legislation on investment screening.

Table 2: Indicators of a geopoliticization of Chinese FDIs in the EU: Empirical evidence

| **Indicator** | Confirmed? |
|---|---|
| 1. Geopolitical framing of EU-China investment relations embedded in and preceded by broader geopolitical framing of EU-China economic relations. | Yes |
| 2. Agenda-setting by the public, not by private actors. | Yes |
| 3. Agenda-setting by security-related institutions / ministries | No |
| 4. Decision-makers articulate security concerns in order to make the case for investment screening. | Yes |
| 5. Criteria used to evaluate and vet investments are well-defined, concise, and narrowly security-related. | No, a broad range of criteria |
| 6. Time horizons of decision-makers are getting longer as longer-term power resources implications of FDI gain in importance. | Yes |
| 7. FDI by Chinese state-owned or controlled enterprises raise particular security concerns. | Yes |
| 8. Governments block acquisitions on security grounds, even if the European company has to face economic losses as a consequence | Yes, in individual cases |
| 9. Decisions to block Chinese FDI mainly relate to the defence sector, dual-use goods, and critical infrastructures. | Yes, in the German case |
| 10. Chinese FDIs and the European regulatory response to them gain political salience beyond the narrow policy networks dealing with investment relations. | Individual cases of high salience (KUKA) |

Source: Own compilation

Table 2 summarizes key findings of this paper. Overall, a mixed picture emerges. We find clear evidence that geopolitical concerns and security interest gained in importance and

provided a rationale for policy change both on the European and the national level. The longer-term concerns of governments most actively pushing for EU legislation on investment screening revolved more around economic long-term interests and were rarely framed in global power struggle language as they routinely are in the US. Security concerns in Europe are more narrowly concerned with the disruptive potential of Chinese investments in critical infrastructure and with a direct military use of cutting edge technologies, less so with the long term Chinese economic benefit flowing from investments in EU member states that could strengthen the resource base of China's power and geopolitical strategy.

The EU did not fully replace its mainly liberal economic paradigm for assessing the costs and benefits of economic and investment relations with China with a realist geopolitical paradigm. We rather see a layering of geopolitical frames and interest onto the liberal paradigm and the addition of instruments of economic protectionism to the EU's toolbox, without renouncing its liberal approach to inbound FDI altogether.

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