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Strategic Autonomy or On-top-of-me?

The CAI and the EU Journey to the East

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Summary

- After seven years and significant concessions from China, the EU-China Comprehensive Agreement on Investment (CAI) got a final push across the line end-2020 from Germany
- On paper, the CAI should improve EU companies' access to China and 'level' the playing field
- Balance of payments data show the EU has been a bigger (direct) investor in China over the past decades than China has been in the EU, but this balance has shifted since 2010, as the EU's openness as compared to China's lack thereof had started to bite
- The CAI aims to steer China towards more openness, sustainability and fairer labor practices, but its commitments are 'weak' and the envisaged dispute resolution mechanism lacks teeth
- Against the backdrop of the EU's strive for more 'strategic autonomy', the agreement is at risk of becoming a strategic failure considering that: i) the US were side-lined; ii) China may benefit more than the EU; and iii) China has a long tradition of understanding strategic autonomy realpolitik in a manner the EU, with free-market ideology, does not

"It was my destiny to join in a great experience. Having had the good fortune to belong to the League, I was permitted to be a participant in a unique journey."

Herman Hesse, Journey to the East (1932)

Agreement in Principle; but Principled Agreement?

"I imagine that every historian is similarly affected when he begins to record the events of some period and wishes to portray them sincerely. Where is the center of events, the common standpoint around which they revolve and which gives them cohesion? In order that something like cohesion, something like causality, that some kind of meaning might ensue and that it can in some way be narrated, the historian must invent units, a hero, a nation, an idea, and he must allow to happen to this invented unit what has in reality happened to the nameless."

At the end of December 2020, the EU and China signed the Comprehensive Agreement on Investment (CAI) in principle. Even in November 2020 there appeared no likelihood of a deal being done due to large remaining differences: then things suddenly changed for the better.

Even given the odd holiday-period timing, this deal generated a lot of headlines. This was partly due to the positive economic and financial implications: but even more so due to the potentially *negative* political and geopolitical ones.

This report will attempt to summarize and assess these sharply different dimensions of the CAI. In doing so we will argue that it can be seen as an economic 'win-win' by optimists that underlines the EU's "strategic autonomy"; however we will also argue that it can be seen as irrelevant; and at worst as a Journey to the East that ends up with EU suffering from "Strategic On-top-of-me" vis-à-vis China.

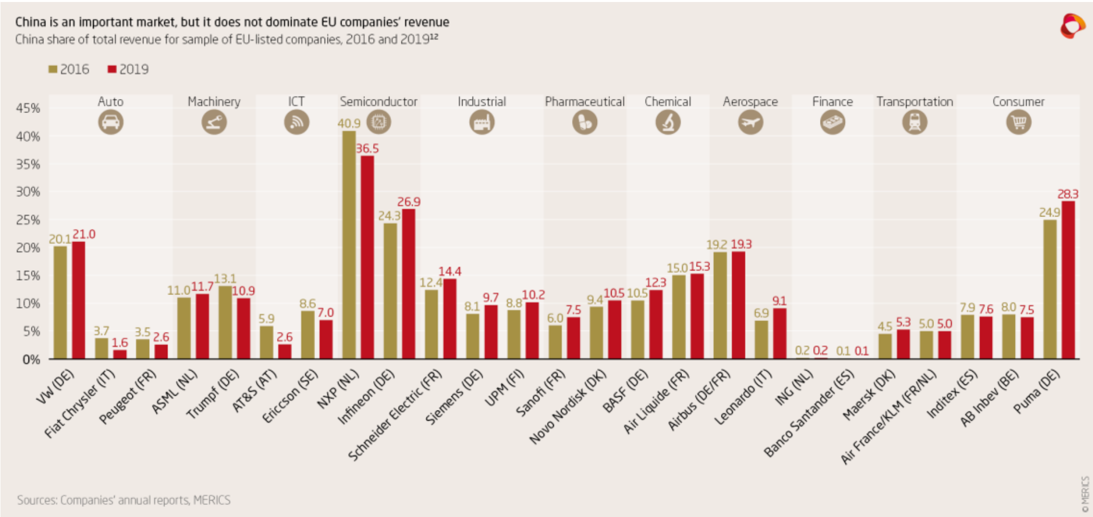
A Seven-Year Journey to the East

"For our goal was not only the East, or rather the East was not only a country and something geographical, but it was the home and youth of the soul, it was everywhere and nowhere, it was the union of all times."

Notably, the CAI has been in development for almost seven years and got across the line just before end-2020, which was the self-imposed deadline agreed at the EU-China summit in April 2019.

Clearly, however, this is a legacy project for Germany's Angela Merkel. Yet while this may be a valid 'vanity' reason, there is little doubt that **economic interests have played a significant role as well**. Of the EUR 152bn cumulative FDI flows from the EU28 to China between 2008 and 2019, 47% has been from Germany. So German businesses in particular have been diving deep into China for many years, and some of the other biggest European companies already have significant stakes there. (Notably, German media report a Merkel-Xi side-bar agreement allowing Deutsche Telekom access to the Chinese market, including owning infrastructure, and China Telecom access to the German market: this despite rising national security concerns over such sensitive issues – which we will explore more later.)

Figure 1: Das ist meine Cash-Kuh



Source: [Merics]()

The German push for the deal has already seen some muttering from other EU members, but as yet no official reaction. So has France: President Macron having inserted himself prominently into the final CAI negotiation process despite having no official role to do so, a key protocol that the EU notably refused to break even during knife-edge Brexit negotiations. Clearly the CAI means a lot to some people.

As the EU relates it, eventual CAI agreement was not related to Donald Trump having received 74 million votes in November for an 'America First' policy, or the looming year-end self-imposed deadline, or the looming end of Merkel's term in office in 2021 (honest!), or the end-2020 Brexit deal leaving the EU looking for a significant countervailing global victory. **Rather it was because China had made significant concessions**, and this was the best deal that would ever be on the table for Europe.

Devil in the details for some; the dance for others

"Everything becomes questionable as soon as I consider it closely, everything slips away and dissolves."

The full and final text of the CAI is not yet available, to the dismay of observers already concerned about the lack of transparency in a key bilateral deal with a country also not famed for its transparency. However, the provisional text reveals the **CAI should improve access for EU companies to China's market in different sectors of manufacturing and services, and level the playing field for European companies active in China.**

Depending on the sector, improved access will be reached via the removal of joint venture requirements, equity caps and quantitative restrictions, including in the automotive sector and services such as private hospitals in certain regions, financial and online computer services, and business, environmental, and construction services. However, **it will exclude sectors with 'large overcapacity'** – which in China's case is a large number. Furthermore, China has agreed to remove outright foreign investment bans, i.e., to open up certain markets such as new energy vehicles, cloud services (with a 50% equity cap), land-based international maritime transport activities, and several air-transport related services.

From the other side, **China would mainly gain guarantees that it can continue to access the EU market as it already does now**. It could also count on some additional market access in the manufacturing sector, but it is not spelled out in the principle agreement which sub-sectors exactly these would be. It is clear, though, that the EU would hold on to the right to limit or even prohibit Chinese access in 'sensitive' areas at a member state level.

Apart from liberalizing market access, **the agreement seeks to force Chinese State Owned Enterprises (SOEs) to behave more like private companies**. In particular, China has pledged to be transparent on the use of subsidies in the services sector – *but not in the industrial/manufacturing sectors where this practice is also widespread.*

China has also pledged to stop forced technology transfers by European firms operating in China – a longstanding grievance, which the EU has not been able to fight/reform successfully despite China's commitments to WTO regulation. (China has repeatedly denied that these transfers happen, so is pledging to stop doing something it insists it has not done.)

Furthermore, **China should improve transparency and level the playing field** for European companies regarding authorizations, standards and all sorts of regulatory and administrative measures and requirements.

China also *commits* to implementing the Paris Climate Agreement, not to weaken labor and environmental protection; and, in much weaker language where politics enters the picture, **to "*work towards*" ratifying ILO conventions regarding forced labor**. Notably, this is regarded as weak language, legally. It is also a highly contentious area given allegations of human rights abuses/forced labor of the Uighur minority (see here). The EU argues China has now made a commitment, and that it is time for a carrot-rather-than-stick approach. However, critics question if there is any serious intention to implement these ILO standards, and that if there isn't, if a carrot sends the right global signal for a key area of supposed 'EU values' differentiation. By contrast, the US, UK, and Canada have all taken steps to block the import of some products allegedly made in China by forced labor and/or to impose sanctions on those seen as responsible. This leaves the EU looking out of step with other Western economies.

In short, there are questions over the 'micro' details of CAI from some of its critics, and at the 'macro' policy level from others. (We shall shortly come to the 'meta' critics.)

The European economic rationale

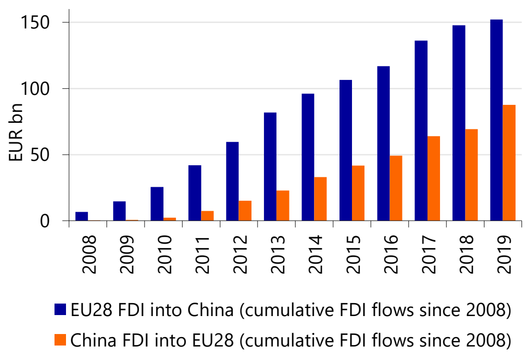
"Words do not express thoughts very well; everything immediately becomes a little different, a little distorted, a little foolish. And yet it pleases me and seems right that what is of value and wisdom to one man seems nonsense to another."

Since China seems to have made more concessions than the EU, one could argue that EU will have most of the economic gains. EU companies will improve their competitive positions against incumbent Chinese firms and gain increased access to a large market as compared to the status quo. Moreover, their past investments in China (on paper at least) should be better protected than before the CAI – no more forced technology transfers or significant limits on ownership. We note that the exact impact of improved access remains to be seen, given that for example industries with large overcapacity (not yet defined in provisional text) will be excluded, the auto sector is oversupplied (with the Chinese electric vehicle market already having experienced a boom and bust), access to private hospitals is geographically limited and that it is unclear what European banks can do in a heavily controlled Chinese financial system.

Yet this will logically see changes over time in how European firms operate and even think: with growth in China set to outstrip that of the EU going forwards, *the relative share of corporate profits sourced from China will only increase with it*. This has already been seen with US firms, for example, where some larger firms clearly see their future growth in China. (And note that this is despite the much more hawkish line on China taken by many if not most US politicians).

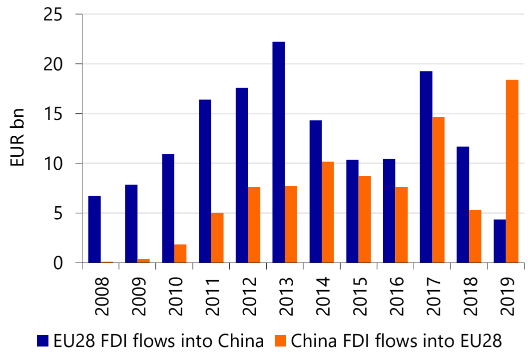
Economic data show that investment relations between the EU and China have grown steadily over time with the EU having larger investment positions in China than China in the EU (figure 2). But where FDI from European companies in China has slowed down in recent years, **China has become a bigger player in the EU** (figure 3). This development has clearly given impetus to the debate in Europe on how to protect its current interests and how to improve its access to Chinese markets in future – thus the CAI.

Figure 2: The EU the bigger investor in China...



Note: Data includes UK. Series without UK only start in 2013.
Source: Macrobond, Eurostat

Figure 3: ...but not in 2019 by any means

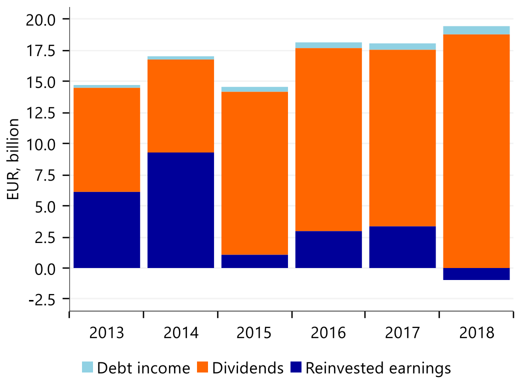


Note: Data includes UK. Series without UK only start in 2013.
Source: Macrobond, Eurostat

Despite certain limitations on the ability of foreign firms active in China to plough back profits, European companies have managed to make decent (albeit declining) returns on their investments there to date, mostly through dividends, as balance of payments data show (figure 4). At the same time, it is fair to say that the overall amount of income remains quite small when compared to the EUR16.5trn EU economy, which at least partly results from the fact that the overall direct investment position of the EU in China is relatively small when compared to GDP (figure 7). Germany has been the main beneficiary of those investment returns by far (figure 5), which is related to its larger FDI position in China as compared to EU peers (figure 6) and, as we have already shown (figure 1), this is concentrated in a few politically-powerful firms.

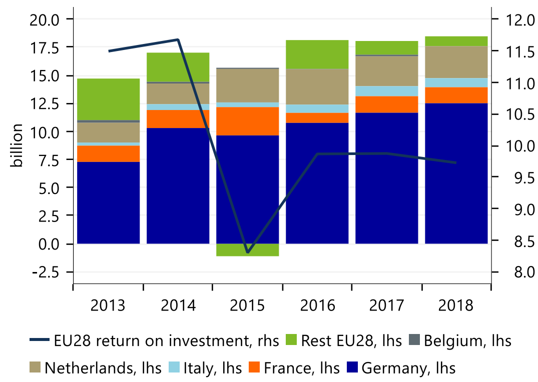
This is important to consider, because it shows that while on one hand the economic numbers here are quite small, on the other they are in 'vital' areas, politically. A comparison can be made with human anatomy of course: the heart is a vital organ despite its relatively small volume within the average body.

Figure 4: EU28 investment flows from China FDI



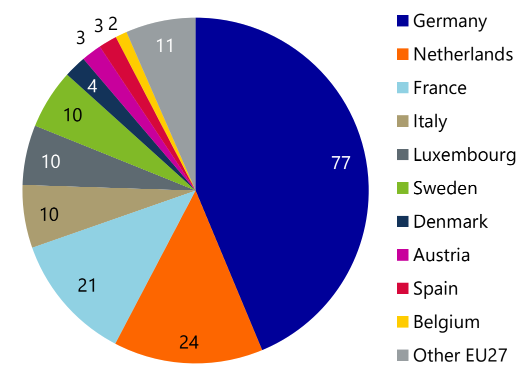
Source: Macrobond

Figure 5: Member state FDI flows from China



Source: Macrobond

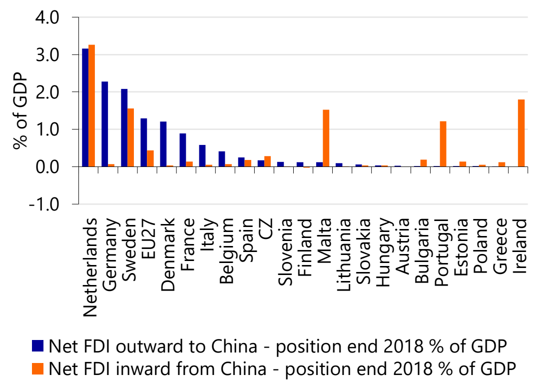
Figure 6: Net FDI into China, EURbn (2018)



Note: Data for Ireland is not available

Source: Macrobond, Eurostat, IMF CDIS, RaboResearch

Figure 7: Net flows of FDI are still small overall



Note: Luxembourg and Cyprus have been omitted because of troublesome data
Source: Macrobond, Eurostat, IMF CDIS, RaboResearch

Another economic rationale is that *if* this CAI leads to increased FDI from the EU to China, European firms should be able to profit more from China-EU trade; that is to say that a larger share of exports *from* China to the EU will be from EU firms *in* China (which in turn means higher profits for them).

Yet, **it remains to be seen who is the real winner if this allows China greater de facto leverage over said firms**, which we will come to in a moment. At the same time, the transfer of capital and, more so, of EU high technology, would allow China to move even further up the value chain even faster than it already is, so enabling it to compete in other areas with EU companies (see the box on p.10).

Indeed, **the CAI also does not preclude the possibility of a *willing* technology transfer by EU firms** that accelerates the above process as their relative scale and position in China grows. Again, these allegations are clearly part of the US-China trade tensions: and the EU is once again extremely tentative in going down the same path.

The starting point for trade in any case is not great for the EU. China already dominates bilateral trade in both high-tech (for goods such as mobile phones) and low-tech (e.g., toys), while it is only in medium-tech (mainly automotive) and food where the EU has been making progress. Automotive would likely be one of the very first areas that EU investment will increase under CAI, however: could China one day in the future be exporting cars to the EU and not the other way round? What would stop that happening?

In short, although this CAI is not about trade but about rebalancing the existing asymmetry in terms of market access while committing China to the 'EU's standards' related to sustainable development --and at the same time preserving (or regaining) EU control in sensitive areas and sectors-- there could easily be **unintended negative externalities** that come with it over the longer term.

After all, more imports from China (even of products produced by EU-held companies) would still mean lower exports to China *from* the EU, all other things equal – and so fewer jobs. The US has experienced exactly this over the years, allege its China hawks.

Importantly, all of the above worries are still assuming that the day-to-day usage of the CAI runs smoothly and that neither side falls short in its commitments: and that is also something that is far from assured given the historical, and very-recent, track record on this front.

Dispute resolution is not resolute

"…devoted to small details exalts us and increases our strength."

If either party does not adhere to the commitments made in the CAI, it can resort to a (state-to-state) dispute resolution mechanism. This entails a framework to work out issues via dialogue and consultations, but also an arbitration panel in case a solution cannot be reached. Ultimately, **penalties or approval for retaliation could be imposed for failed CAI commitments - *apart* from the key 'sustainability goals', i.e. environmental and labor policies.**

The CAI dispute mechanism is comparable with dispute settlement within the WTO, only faster according to officials. With detailed text still lacking, our interpretation of the provisional texts, and taking into account FTA's the EU signed with other countries, suggests that non-adherence to sustainability commitments could ultimately be escalated to a panel of experts, who should provide the offending party with advice and recommendations - but a penalty again seems out of scope. **As such, the CAI has no real teeth**.

To illustrate, after eight years, the FTA signed between the EU and South Korea in 2011 has delivered few results with respect to ratification of certain ILO conventions. The EU has escalated the issue and at the end of 2019/early 2020 a panel of experts was tasked to review the situation; however, it is still unclear whether that has had or will have the desired result - the ratification and implementation of ILO conventions in South Korea.

If there are no teeth on the really 'meaty' issues, it of course also remains to be seen whether China can be held to several other CAI obligations, such as the transparency rules for service-sector subsidies and the behavior of SOEs. So far, present WTO regulations regarding SOE behavior and industry subsidies have not been able to sufficiently move China on these fronts, despite the WTO's dispute settlement mechanism – which has only been out of order since end 2019.

It's the Final CAI-nt Down

"I now accepted the hours of despair as one accepts acute physical pain; one endures it, complainingly or defiantly; one feels it swell and increase, and sometimes there is a raging or mocking curiosity as to how much further it can go, to what extent the pain can still increase."

Going forward, **the timeline for signing the actual CAI is not set in stone.** Full text including annexes is expected to be finalized over the course of Q1 2021, after which its legality will need to be checked. Thereafter the process of approval by the European Parliament (EP) and European Council (EC) can start. It seems fair to assume that such a process needs several months as well, but in all fairness it's not really possible to put an 'exact' timeframe on it.

Not the least, because **the position of the EP is not known.** EU sources loudly state in public that they think China's commitments to ratify and honor ILO conventions are too soft, making it impossible for them to agree with the CAI in its current form – and it highly questionable if China would ever agree to a revised agreement in that regard. However, the majority view has not been communicated yet, and strong lobbying by German and French businesses can be expected.

At the very least, we can expect a contentious debate on the topic. (And note that on top of the CAI, China and the EU have also committed to complete negotiations on investment protection and investment dispute settlement within 2 years of the signature of the CAI itself: this would considerably broaden the scope of the discussions.)

Strategic Autonomy…

"He who travels far will often see things Far removed from what he believed was Truth. When he talks about it in the fields at home, He is often accused of lying, For the obdurate people will not believe What they do not see and distinctly feel. Inexperience, I believe, Will give little credence to my song."

Some would say this deal with China is a key example of bringing to bear the EU's new buzzword of *'strategic autonomy'*. As we wrote in a special last year, there have been tangible signs of the EU trying to strengthen its lead on several fronts; an ambition that undoubtedly has been spurred by both 'America First' and 'Made in China 2025'.

The most tangible evidence of this development has been the relatively swift and coordinated response to the Covid-19 shock, the EU 7-year budget deal and Recovery Fund agreement. Yet the Commission's drive in shaping structural economic policy and even a new industrial strategy are also tangible changes, where 'sustainability' permeates everywhere.

On top of that, the EU has become more vocal on its ambition to drive change externally, i.e., the partners it trades with, for example. In her State of the Union speech, EC President Von der Leyen specifically referred to the issue of human rights abuses and sanctions implementation, calling for a European Magnitsky Act and improved foreign policy coordination. Indeed, there are clearly parallels between CAI and the Phase One trade agreement between the US and China, signed on 15 January 2020 without any input or feedback from the EU.

As such, this new CAI can be seen as a logical external extension of the EU's wish to create strategic autonomy and project its influence.

The EU vision here is that the CAI includes commitments to raise standards of labor and environmental protection and implement ratified ILO Conventions. It also aims to level the playing field *and* improve access for European businesses in China, whilst at the same time preserving the *"policy space in sensitive sectors"* in both the EU and China.

This *could* provide a rules-based system to the EU's liking and yet also ensures both more free trade and that EU autonomy can be maintained in key areas.

Yet it also sounds too good to be true - and *ironically just like the official British rhetoric on the UK post-Brexit future!*

Indeed, this all hinges on whether the CAI improves the EU's strategic autonomy or not: *and it seems very unlikely that it will.*

First, **there does not even appear to be a common understanding within the EU of what "strategic autonomy" means**. We would argue it involves more than protecting certain business sectors, helping to set (global) standards and signing trade or investment deals with other jurisdictions. **Strategic autonomy implies the power (financial, economic, and military) to enforce agreements or *not* to be forced by others.**

The EU's biggest Achilles' heel remains the overwhelming lack of willingness among member states to transfer sovereignty upwards. As such the EU itself plays second fiddle in international financial markets to the Eurodollar, and it also remains reliant on the existing US military alliance. One must also consider that when the EU deals with China it is dealing with a political economy that is: 1) not constrained by the above limitations; and 2) is not operating on the same underlying basis in terms of its view of how political economy works.

...or Strategic On-top-of-me?

"My tale becomes even more difficult because we not only wandered through Space, but also through Time. We moved towards the East, but we also travelled into the Middle Ages and the Golden Age..."

Crucially, for the technocratic EU, politics is politics and economics is economics: for China the two are always joined at the hip.

Ironically, the EU largely splitting the two issues on the CAI (with loose language and toothless commitments) is therefore a strategic *weakness* for Europe as China can always outflank it with a more united approach. Allow us to illustrate how so.

China has a very long historical tradition of understanding all dimensions of strategic autonomy realpolitik in a manner the EU, with its free-market ideology, no longer does. (Europe used to, of course, but a long time ago). For example China:

- Does not want key sectors of its economy with national security implications to be controlled by foreigners – a stance the EU is now only belatedly starting to mirror in part but cannot replicate in full due to free market commitments;

- Maintains national champion SOEs in key sectors to provide scale and global heft as well as direct strategic control of the economy. The EU has again seen a belated and tentative move in this anti-competitive/champion direction recently but again cannot truly compete this way due to its own regulations;

- Does not like relying on foreign suppliers unless necessary – a point underlined by the recent threat of US technology controls on its firms. The official directive is now for China to diversify industrial material imports towards only "reliable" and "controllable" supply chains, or to develop local alternatives via industrial policy no matter the cost. The free-trade EU has no such thinking and will not, and could not, do the same in the same manner;

- Is aware it can use its own supply chains to *withhold* key goods from others. Chinese press alluded to doing this to the US with some medicines during the heights of the Covid-19 crisis when China-US rhetoric was its most bitter, and in regards to access to rare earths. The EU seems unlikely to consider acting in this manner (although this is not set in stone);

- Has long used its access to market as a carrot. Yes, the EU does the same. But the difference is that once foreign firms are deeply embedded in its economy, China is willing to punish them to achieve unrelated goals. The recent example of Australian export bans and 14 demands made on Canberra by Beijing (including muzzling the press and removing new foreign relations laws which give the federal government power to veto state or local government agreements with foreign governments: as the Australian press state *"it would be impossible for any Australian government to satisfy all the demands without ceding its sovereignty."*) underline this point. The EU would never be able to do the same – once a firm is into its markets, one gets a true level playing field; and

- China is quite prepared to take economic pain to achieve larger political goals: it was even willing to stop Australian coal imports despite suffering power cuts during the winter. The EU, both because of its rule of law and its consumer society, would not be able to act the same way.

In short, the EU effectively has one hand tied behind its back if it comes to a fight due to its own standards, rules, commitments, and beliefs (e.g., free markets).

By contrast, China --while willing to use markets where necessary-- also fully understands both monopoly and monopsony power, how to take asymmetrical action, and how they can all be used as pressure points on foreign firms to then pressure their governments into making policy concessions in areas that further deepen Chinese power. As just one recent example, the CEO of Ericsson has lobbied his own government not to ban Huawei, even though that step would open the door for the firm to eventually dominate in the EU and other Western economies, on the grounds that it also risked the firm losing the Chinese market immediately.

As we noted on the dispute resolution mechanisms, what would happen if it turns out China has not lived up to its commitments in CAI after a few years? Would the EU take painful actions that damage key European businesses interests, or would those firms pressure the EU to 'not make a fuss'? The EU would surely find it almost impossible to act collectively, decisively, and quickly.

One would have thought that the trade- and human rights-focused EU would have noticed what has happened to trade-, rules- and China-focused Australia, with its tattered FTA; or to the US-China Phase One trade deal, with its missed purchase commitments; or to Hong Kong and the gutted Sino-UK Joint Declaration. It did not - and within days of the CAI being agreed China arrested 53 lawmakers and activists in Hong Kong. Such actions suggest Beijing already realises it can act knowing that the EU, which has just sunk its political capital into the CAI, will blink.

To underline again, one also has to understand that the longer **no such issues arise, the greater the potential economic damage to EU firms would then be if Beijing *were* to act.**

More short term, however, there are already warning signs. Beijing has just introduced legislation making firms operating in China liable for damages if they comply with foreign legislation that hurts Chinese interests: for example, EU firms required to implement sanctions on a Chinese entity due to any US or future EU Magnitsky legislation. This would set up an immediate clash of who has the *real* strategic autonomy, and could potentially force firms to either leave China, leave other markets, or make a choice to split into two entirely unconnected legal and financial entities, one for China and one for the rest of the world.

How China benefits from the CAI

The CAI is clearly a geopolitical win for China. China has been facing pressure from multiple sides in the past year, from increasingly **negative perceptions** worldwide, increasing **tensions with the US**, **India**, Australia, and a backlash over the Hong Kong National Security law. One could argue that the view of China was becoming one of a country that is increasingly isolating itself from the rest of the world, more so since the strategy set out in China's latest Five Year Plan was one of increased **self-reliance**. Then Joe Biden was elected as the new US president, removing the hawkish Trump administration; China signed a new **regional trade deal** (RCEP); and now has an investment deal with the EU to boot. *China can correctly claim that it is not becoming more isolated despite its actions on other fronts.*

From the economic side, however, China will gain substantially as well. Historically, the EU has made more direct investments (FDI) in China than vice versa (Figures 2 and 3), so a net capital inflow for China. A **study** from the Dutch Bureau of Economic analysis estimates that bilateral investment treaties increase FDI stock in a country (compared to not having such a treaty) by 35%. If that applied to China and the increase would occur over 10 years, it would mean an extra EUR5bn worth of FDI into China from the EU per year (35% of EUR152bn, spread out over 10 years). For an economy that has periodically been short of foreign exchange, and which needs to expand FX reserves to match the expansion in local money supply, this is helpful if not a game changer.

If FDI between China and the EU increases, it would arguably benefit China more directly than Chinese FDI into the EU. For China, increased FDI will lead to more FX, more jobs, and more employment. For the EU, the gains would only be FX (which using EUR, a true global reserve currency, it does not need) and more jobs: the knowledge flow would be one-way.

Indeed, more FDI into China --especially technology related-- could also accelerate China's rapid move up the value chain. In time, some of those Chinese high tech products could compete for the same market as European tech products. That might be difficult to swallow for the European firms that get 'out-tech-ed' by Chinese firms and ultimately lose market share abroad and at home. As with the US already, that could lead to further EU China tensions down the line.

This, to some extent, is borne out by revealed competitive advantage indices, which show the relative share of exports to world exports (See Figures 11-13). China has an advantage in high tech (mobile phones), which has grown a lot over time, and China has been moving up the value chain away from low-tech (toys), although it remains much specialized in this area. It has been losing specialization advantage in food. The EU, in contrast, remains strong in medium-tech (automotive) but has failed to make significant gains in high-tech.

From a related trade perspective, the EU already runs a deficit of almost EUR200bln with China as well (Figure 8). China is currently a net exporter to the EU of electronics, lights and toys Figure 9), while the EU is a net exporter of beverages, mineral fuels and food (Figure 10). The trend towards more trade and a Chinese step up the value ladder would then allow China to use more of its excess industrial capacity, earn additional extra FX from the EU, *and* place it in the strategic position of commanding more supply chains into Europe.

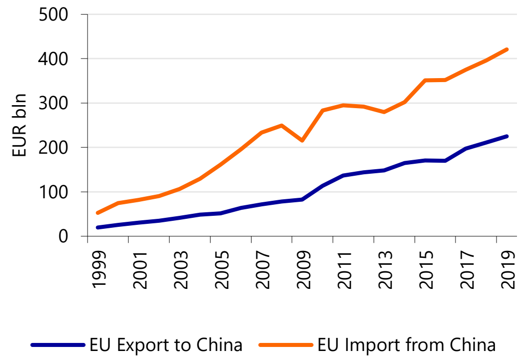
At that point, were geopolitical tensions between the EU and China to rise, China might be more willing than the EU to take a short-term economic hit in order to show which of the two has true strategic autonomy: would the free-trade EU be prepared to shift away from Chinese goods --if it had a choice-- by linking politics and economics?

In all these senses China would arguably have more economic leverage over the EU than vice versa from the CAI, especially since it has that leverage over the largest firms in the largest economy in the EU (Germany).

The EU-China trade relationship in charts

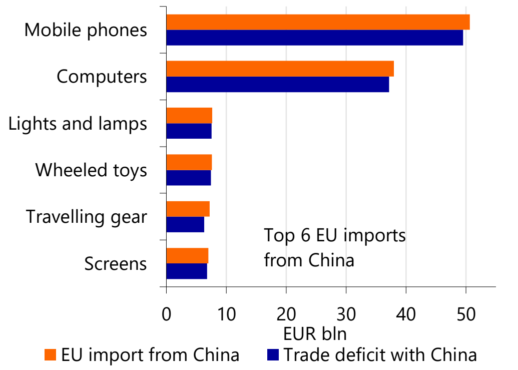
"Faith is stronger than so-called reason."

Figure 8: The EU runs a big China trade deficit



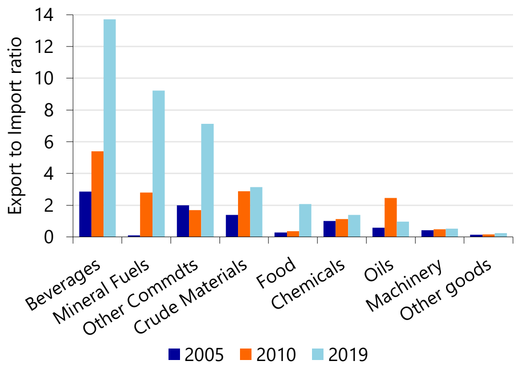
Source: Macrobond, Eurostat

Figure 9: Most notably in tech and toys



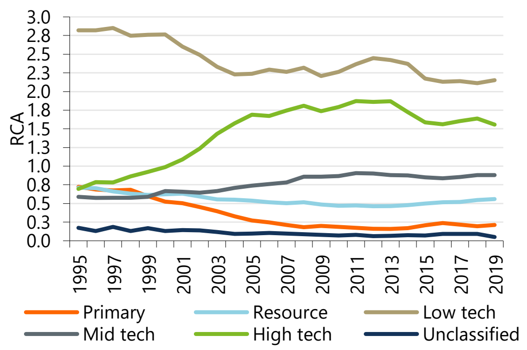
Source: Trademap.org

Figure 10: Only EU food, drinks, and fuels win big



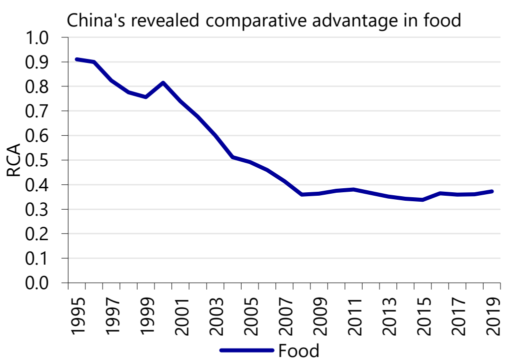
Source: Macrobond, Eurostat

Figure 11: China is hunting high and low



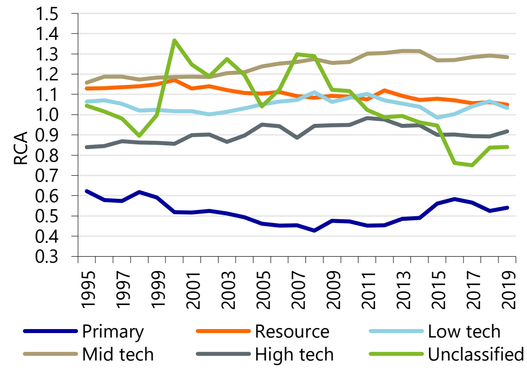
Source: Trademap.org

Figure 12: China's been losing out on food



Source: Source: Trademap.org

Figure 13: Stuck in the middle with EU – for now



Source: Source: Trademap.org

US vs. Th-EU-m?

"Once in their youth the light shone for them; they saw the light and followed the star, but then came reason and the mockery of the world; then came faint-heartedness and apparent failure; then came weariness and disillusionment, and so they lost their way again, they became blind again."

One other key aspect of CAI must be mentioned in more detail: **that it happened just weeks before the new US Biden administration enters office.** Of course, under President Trump EU-US relations had taken a downwards turn to the extent that it is suggested that Chancellor Merkel in particular had grown sceptical of the degree to which Europe will be able to rely on the US in the future: thus the need for strategic autonomy, even if half-baked and less than half understood.

President-Elect Biden has spoken about the need for like-minded democratic allies to work together against China to try to achieve the goals that the EU believes it has achieved with the CAI. To have acted on a self-imposed deadline without the approval or cooperation of a new Europhile US leadership can be seen as EU 'Strategic autonomy'.

However, it can also be seen as a slap in the face, and as empowering those in the US who believe the Trumpist argument that the EU is too weak and too unreliable to face the multifaceted dimensions required in dealing with China. This is an approach that can easily come back to haunt the EU in the future, even if the CAI were to fail to pass the European Parliament, and even under a Biden administration. The US will not take kindly to an EU seen as being an economic partner to China in Asia, where the US clearly sees it as a military competitor, while the same EU is expecting US military support against Chinese allies, such as Russia, in its own economic backyard.

As noted, for China this is being seen as a major geopolitical and strategic victory. *The EU signing the CAI potentially shows that even ostensibly likeminded Western economies can be easily divided rather than standing united against China by the simple promise of preferential market access for their firms.* (Which the US-China Phase One trade deal also provided the Americans with – if the commitments had been met in full: the US was, however, still imposing tariffs and tech restrictions on China at that time in conjunction.)

The EU logic remains that it is better to stay on a good footing and try to accomplish changes by keeping communication lines open rather than shutting things down entirely and losing any form of leverage that you may have. This line of reasoning was made popular by Thomas Friedman in his *Golden Arches Theory of Conflict Preventions*, first published in an article in the New York Times in 1996, in which he stated that *"No two countries that both had McDonald's had fought a war against each other since each got its McDonald's"*. He later updated this theory by re-labelling it into the *Dell Theory of Conflict Prevention*, which essentially states that opening up markets and levelling the global playing field contributes to increasing inter-dependence: *"No two countries that are both part of a major global supply chain, like Dell's, will ever fight a war against each other as long as they are both part of the same global supply chain."*[1]

Of course, **that theory blew up when Belgrade was bombed by NATO**, just as the first iteration of the same argument (1909's 'The Great Illusion') blew up in 1914. Three wars by any other name have since occurred between countries with McDonalds: Lebanon-Israel (2006); Georgia-Russia (2008); and Ukraine-Russia (2014). The US, China, *and* Russia all have lots of arches today - but that does not ease escalating geopolitical tensions. Yet in neoliberal economics if the theory justifies short-term profits then the actual facts don't seem to matter.

[1] In: "The Lexus and the Olive Tree" (1999)

Crucially, **we should bear in mind that the EU itself was very much built on a utopian idea**. The 11 founding fathers of the Union (of which Winston Churchill was one) saw a united Europe as a means to avoid future conflict in a post-WW2 world. Intergovernmental cooperation and integration were the means to accomplish change, even if this process turned out to be volatile at times. Even so, crises would eventually lead to solutions that would lead to further integration.

Whether one agrees with this view of the world or not, it helps to understand why the EU has a strong preference to 'keep talking' in order to maintain certain leverage. **The issue is if such an approach works with a totally different political-economy like China, with a very different history, culture, goals, and its own ideals of statecraft and strategic autonomy.**

After all, the world has changed a lot since the 1990s as these issues have come to the fore. As Foreign Policy magazine wrote in November 2020, "*The Beautiful, Dumb Dream of McDonald's Peace Theory: In the rich, lazy, and happy 1990s, Americans imagined a world that could be just like them.*"

It just appears that the EU has not changed as much, or to match – or so the CAI suggests to its critics.

In conclusion then:

1) the CAI could **theoretically* end up with economic win-wins and EU 'Strategic Autonomy'; but

2) It could fizzle out in the European Parliament, or prove to be a non-starter (China does not comply, so EU firms do nothing; and Chinese firms retain the access they already have); or

3) It could also result in the EU hamstringing itself into a worrying position of 'Strategic On-top-of-me' vis-à-vis China, even if this is not immediately evident.

Let's stay tuned for what happens with this particular Journey to the East.

"The candles burned low and went out. I was overcome by an infinite weariness and desire to sleep, and I turned away to find a place where I could lie down and sleep."

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