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FOREIGN DIRECT INVESTMENT FROM EU COUNTRIES AS INSTRUMENTS FOR FINANCING CHINA'S RAPID ECONOMIC GROWTH: SECURITY RISKS

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ABSTRACT

The aim of the article is to justify the role of foreign direct investment (FDI) from European Union countries as a financial instrument supporting China's rapid economic growth, while emphasizing the security implications of such investment for Europe and the global economic system. The relevance of the study is reinforced by intensifying geopolitical tensions, the European Union's transition toward a policy of "de-risking" and strategic autonomy, and the growing securitization of trade, technology, and investment policies that increasingly link international capital flows to issues of resilience, technological sovereignty, and control over critical assets. The article examines the theoretical foundations of investment-driven interdependence and the mechanisms through which EU-origin capital contributes to China's industrial modernization, technological upgrading, and expansion of innovation capacity in technology-intensive sectors. Particular attention is devoted to the institutional environment shaping EU–China investment relations and to structural vulnerabilities that may arise from deep economic integration. These vulnerabilities include the diffusion of dual-use technologies, cross-border knowledge transfer, and the emergence of dependencies in strategically important supply chains that may weaken the EU's economic security and strategic autonomy. Using empirical evidence for the period 1990–2024, the study identifies a strong positive association between EU FDI inflows, China's GDP growth dynamics, and indicators of technological development. At the same time, the analysis suggests that sustained economic expansion supported by foreign capital may indirectly contribute to the growth of China's military expenditure and the strengthening of technological capabilities with potential defense applications. These dynamics highlight the broader security externalities associated with investment cooperation in high-technology and dual-use sectors. The results support the need to strengthen EU-level investment screening mechanisms and to adopt a risk-based, sector-specific approach to FDI governance in order to balance economic openness with security considerations under conditions of increasing geopolitical competition.

Keywords: investment in innovation, dual-use technologies, China's modernization, European financial security, investment screening, sectoral regulation of FDI, military expenditure, technology leakage, security risks

JEL Classification: H56, F02, F21, O14, O33, O52, O53

INTRODUCTION

Over recent decades, EU Member States have expanded investment engagement with China, including in high-technology domains such as artificial intelligence, telecommunications, advanced manufacturing, and emerging digital infrastructures. While these investment flows have supported market access for European firms and contributed to deeper integration of China into global value chains, they have also intensified debates about how economic interdependence intersects with strategic competition and security externalities (Rodrik, 2011; Reinert, 2019).

Foreign direct investment (FDI) is widely recognized as a channel for capital formation, productivity growth, and technology diffusion. In host economies, FDI can accelerate

industrial upgrading by strengthening supply chains, expanding R&D capacity, and enabling access to managerial know-how and international markets (Stiglitz, 2012; Piketty, 2014). At the same time, the distributional and structural consequences of global capital mobility remain contested, particularly where investment reinforces asymmetric dependencies or amplifies power imbalances across the international economy (Piketty, 2014; Reinert, 2019).

In the EU–China context, a growing strand of scholarship argues that investment-driven technology diffusion can create strategic vulnerabilities when advanced capabilities have dual-use potential. From a political-economy perspective, the governance problem is not FDI per se, but the absence of adequate safeguards in sectors where technological spillovers may be repurposed beyond civilian markets (Rodrik, 2011; Reinert, 2019). Moreover, high volumes of cross-border capital flows can generate an "illusion of stability" and delay risk recognition, an insight that has been widely discussed in the broader literature on financial and political economy crises (Reinhart & Rogoff, 2009).

China has explicitly pursued a dual-use approach to modernization, aiming to strengthen both civilian innovation capacity and defense-relevant technological capabilities. Policy frameworks associated with industrial upgrading have emphasized accelerated access to frontier technologies and the scaling of domestic innovation ecosystems, including in strategically sensitive sectors. In parallel, the sustained rise in China's defense expenditure has elevated concerns regarding the downstream use of advanced technologies and industrial know-how embedded in international investment linkages (SIPRI, 2023/2024).

Russia's war against Ukraine has further amplified the urgency of reassessing economic cooperation with authoritarian regimes through a security lens. The experience of extensive European economic engagement with Russia despite explicit signals of revisionist intent has reinforced the argument that investment relationships can create strategic dependencies and limit policy flexibility, particularly under conditions of geopolitical confrontation. This context has strengthened calls to treat investment governance as part of a broader security toolkit rather than a purely commercial policy area.

Against this backdrop, China's transition from low-technology manufacturing to innovation-intensive growth raises a central research question: to what extent have EU FDI inflows contributed to China's technological upgrading and, indirectly, to the expansion of defence-relevant capabilities? Addressing this question requires an analytical framework that considers both economic returns and security externalities, especially in dual-use domains where technology transfer is difficult to trace, and cumulative effects emerge over long horizons (Reinert, 2019; SIPRI, 2023/2024).

Accordingly, recent EU policy discussions increasingly emphasise risk-based investment governance, including strengthened screening for strategically sensitive sectors (European Commission, 2024–2025). Developing such instruments is essential to preserve the benefits of economic cooperation while mitigating vulnerabilities that may affect European strategic autonomy and broader international security.

LITERATURE REVIEW

Foreign direct investment (FDI) and its impact on economic development remain among the central topics in contemporary scholarship. In particular, Joseph E. Stiglitz (2012), in The Price of Inequality, argues that FDI can substantially accelerate growth in developing economies by fostering innovation, creating new jobs, and expanding access to global markets. At the same time, he cautions that neglecting domestic structural specificities may deepen socio-economic inequality and exacerbate structural imbalances.

Dani Rodrik (2011), examining the paradoxes of globalization, emphasizes the need to regulate cross-border capital flows in order to mitigate risks stemming from excessive dependence on foreign capital. He notes that, in the pursuit of rapid economic growth, governments often discount long-term security considerations.

Among foundational contributions on capital accumulation, Thomas Piketty (2014) demonstrates that the globalization of investment intensifies inequality not only within countries but also between them. From this perspective, international FDI may function not only as a development instrument but also as a channel of asymmetric influence within the global economic system.

Comparable risks are highlighted by Carmen M. Reinhart and Kenneth S. Rogoff (2009), who show that large-scale transnational capital inflows frequently precede financial crises and may create an illusion of sustainable growth. In the case of China, this dynamic is reflected in the strategic use of FDI to support technology-driven advancement.

Research by C. Wei (2020) indicates that European investment played a pivotal role in modernizing China's telecommunications and automotive industries. However, under conditions of intensified geopolitical competition, such investment is increasingly perceived as a potential challenge to the EU's strategic autonomy.

The security risks associated with the transfer of critical technologies through FDI are also underscored by Erik S. Reinert (2019), who argues that core economies, while extending their economic influence, simultaneously stimulate industrialization in recipient countries, including in sensitive sectors.

Evidence linking China's economic expansion to militarisation is further discussed in SIPRI analyses (2023), which suggest that FDI inflows into high-technology sectors have contributed to the growth of China's military capabilities. In the same context, the European Commission, in analytical briefs published in 2024–2025, stresses the need to strengthen screening mechanisms for FDI in areas such as artificial intelligence, quantum computing, and semiconductors.

S. Gray (2011) argues that economic growth trajectories are inseparable from security strategies; therefore, oversight of FDI should be treated as an integral element of international security policy.

This perspective also intersects with postcolonial critiques of global investment policy. E. Cirincione (2022), for example, analyses Huawei's strategy in Africa as a form of "neo-colonialism" driven by infrastructure expansion and control over the digital environment. Similarly, J. Lindsten (2023) examines Chinese projects in Kazakhstan under the Belt and Road Initiative, highlighting their resemblance to colonial patterns of dependency.

At the theoretical level, these dynamics are explored by Z. Edwards (2020) and N. Rao (2020). Drawing on postcolonial sociology, they argue that the global diffusion of capital often reproduces historical relations of dominance now expressed through investment-based forms of control.

Corporate responsibility and transnational corporate influence in Africa are addressed by A. B. Adanunme (2011), who argues that the economic presence of Chinese firms is frequently accompanied by control over resources, regulatory environments, and social structures.

Overall, the literature indicates that FDI should be understood not merely as an economic instrument, but also as a lever of political and security influence, one that requires systematic reassessment amid ongoing global transformations.

Farrell and Newman's concept of "weaponized interdependence" helps explain why investment-led integration can generate security vulnerabilities even without overt coercion: when firms and states become embedded in global networks with identifiable chokepoints, interdependence may be converted into leverage. In the EU–China context, this lens is particularly relevant for platform dependence and digitally mediated ecosystems, where control over standards, data, and network infrastructure can reshape the balance between commercial efficiency and strategic exposure (Farrell & Newman, 2019).

A complementary strand of research focuses on strategic asset-seeking investment and the policy response it has triggered in Europe. Hanemann, Huotari, and Kratz document how Chinese investment patterns and the EU's subsequent policy debates reflect rising concerns about technology acquisition, critical infrastructure, and security-sensitive capabilities issues that increasingly motivate tighter screening and coordinated governance mechanisms (Hanemann et al., 2019). Although their empirical focus is Chinese FDI into Europe, their findings illuminate the broader logic of reciprocity, strategic sectors, and screening that also frames EU assessment of outward exposure and technology diffusion.

At the global level, UNCTAD's World Investment Report 2024 shows that investment policy in advanced economies has become more restrictive, with FDI screening mechanisms increasingly justified on national security grounds. This trend underscores a structural shift: investment governance is no longer treated solely as an economic facilitation tool, but as a policy domain where states actively manage geopolitical risk, especially in high-technology and critical-infrastructure sectors (UNCTAD, 2024).

OECD work on investment and national security further specifies what "better screening" can mean in practice, emphasizing proportionality, transparency, and predictability so that legitimate security objectives are addressed without producing arbitrary barriers to investment. This policy-oriented literature reinforces the argument for risk-based approaches that focus on genuinely sensitive technologies and ownership structures, rather than blanket restrictions, and for institutional coordination to reduce loopholes across jurisdictions (OECD, 2023–2024).

Ukrainian scholarship increasingly frames investment flows through the lens of economic security, resilience, and regulatory capacity, which strengthens the analytical bridge between FDI economics and security studies in the EU–China debate. In particular, Ukrainian researchers conceptualize investment security as a functional component of national financial and economic security and propose methodological approaches for diagnosing and monitoring vulnerability channels (Danilova, 2019; Kozachenko et al., 2020; Kunytska-Iliash, 2022). Legal and governance aspects of investment screening are also actively developed in Ukrainian academic discourse, including the operationalization of "national security" and "public order" as screening criteria and the need for clearer, enforceable standards aligned with EU practice (Kucheriavenko, 2024; Mazaraki & Honcharova, 2022). At the sectoral and firm levels, Ukrainian studies emphasize how external shocks, structural

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dependencies, and capital scarcity amplify security risks and require risk-based, targeted policy tools rather than blanket restrictions (Ilyash, 2022; Makarenko & Shkreben, 2023; Vakhlakova, 2020; Zubko, 2022). Complementing this, regional and comparative research highlights classification and measurement issues in security assessment and supports the argument for proportionality, transparency, and strategic selectivity principles that are directly applicable when evaluating outward investment exposure, technology diffusion, and critical supply-chain dependencies in conditions of escalating geopolitical rivalry (Koptieva, 2020).

Finally, recent EU-focused analyses frame the current debate through the emerging vocabulary of de-risking, highlighting the difficulty of preserving openness while reducing strategic dependencies in advanced technologies and critical supply chains. Brînza's European Parliament study discusses how the EU's China strategy is increasingly shaped by security considerations and resilience objectives, rather than pure market logic (Brînza, 2024). In parallel, Norris conceptualizes these dynamics as security externalities of economic exchange such as sensitive technology transfer and erosion of strategic industries providing a useful theoretical bridge between investment economics and security studies (Norris, 2025).

AIMS AND OBJECTIVES

The aim of the article is to provide a theoretical rationale and empirical verification of the hypothesis that foreign direct investment (FDI) from European Union countries over the period 1990–2024 has a direct impact as a financing instrument for China's economic rise and, on this basis, to develop scholarly approaches to international investment cooperation with authoritarian regimes under conditions of escalating geopolitical tensions, taking into account risks to Europe's financial security.

To achieve this aim, the article:

1. To document and quantify the relationship between EU FDI, China's GDP growth, and China's military expenditure over 1990–2024 using trend analysis and a correlation matrix.
2. To model dynamic interactions and forecast implications of EU FDI for China's GDP growth and military spending using a VAR framework, including a 2025–2029 projection.
3. To identify security-relevant vulnerabilities (dual-use technology transfer, knowledge spillovers, strategic dependencies) and derive risk-based, sector-specific governance recommendations for the EU under geopolitical escalation.

METHODS

To achieve the study's objectives, a combination of general scientific and specialized research methods was applied. The research includes a review of academic publications, reports produced by European institutions, and analytical materials from the Stockholm International Peace Research Institute (SIPRI). Analysis and synthesis were used to examine the sectoral structure of investment flows, while correlation analysis was employed to identify relationships between key Chinese economic indicators, including GDP and military expenditure. Comparative analysis was applied to assess security risks associated with the transfer of dual-use technologies. Finally, modeling and regression analysis were used to estimate the effect of EU FDI dynamics on the pace of China's economic growth. In addition, analytical trend analysis was applied to assess the broader effects of EU foreign direct investment on selected indicators of China's development. The analysis is based on statistical data from Eurostat, the World Bank, and the SIPRI Military Expenditure Database. This approach made it possible to examine the long-term relationship between EU FDI dynamics and key economic and strategic indicators, including GDP growth, technological development, employment, and military expenditure over the period 1990–2025.

RESULTS

This section presents the empirical evidence on the relationship between EU foreign direct investment (FDI) and China's economic and security-relevant outcomes over 1990–2024, with an extension to 2025 where applicable. Using harmonized open-source statistics, we first describe the long-run dynamics of EU FDI and China's macroeconomic trajectory and then assess the strength of the association between investment inflows, China's GDP growth, and military expenditure. The objective is to establish whether the data are consistent with the study's hypothesis that EU investment has contributed not only to economic upgrading but also to capability accumulation with potential security implications.

The empirical analysis is structured in three steps. First, we document trends in EU FDI and China's military expenditure and GDP over time (Figures 1–2), highlighting periods of acceleration and co-movement. Second, we quantify linear relationships using a correlation matrix (Table 1) to provide a transparent summary of statistical associations among the key variables. Third, we complement descriptive evidence with time-series modelling (VAR) to capture dynamic interactions and to illustrate how changes in EU FDI relate to subsequent movements in China's economic performance and defense spending, thereby linking economic indicators to the security dimension of the study.

Over the past three decades, China has attracted substantial volumes of foreign direct investment (FDI) from European Union (EU) member states, which has materially supported its economic transformation. Whereas in 1990, EU investment in China amounted to USD 10 billion, by 2020 this figure had exceeded USD 176 billion, an increase by a factor of 17.6. European investors channeled capital into strategically significant sectors, including automotive manufacturing, infrastructure, energy, and high technology. Particular attention should be paid to the geographically sustained allocation of investment across Chinese regions, which contributed to reducing regional disparities and fostering new centers of economic activity.

The rapid expansion of FDI was driven by mutual economic incentives: European companies gained access to comparatively lower labour costs and an expanding consumer market, while China strengthened its industrial base and technological capabilities. A prominent role was played by firms such as Volkswagen, Siemens, and Airbus, which facilitated modernisation through the deployment of advanced technologies. Investments in infrastructure, especially transport networks, helped lower logistics costs and supported the development of a more competitive economy (Eurostat, EU–China Investment Data, 2024).

The effectiveness of this cooperation also rested on the adaptation of business models to the specificities of the Chinese market, enabling European corporations to integrate rapidly into local production chains. This, in turn, created additional channels for innovation transfer and supported China's accelerated technological upgrading. The diffusion of dual-use technologies, particularly in electronics and energy, became a key factor in expanding China's research and development capacity. Moreover, cooperation in areas such as renewable energy and transport infrastructure laid the foundations for further progress in sustainable development.

Over the same period, China and the EU exhibited markedly different trajectories of military expenditure, which provides an important contextual lens for assessing the security implications of economic engagement. Figure 1 illustrates that China's military spending increased from relatively low levels in 1990 to over USD 250 billion in 2024, whereas EU defense spending followed a comparatively more stable pattern with only moderate growth.

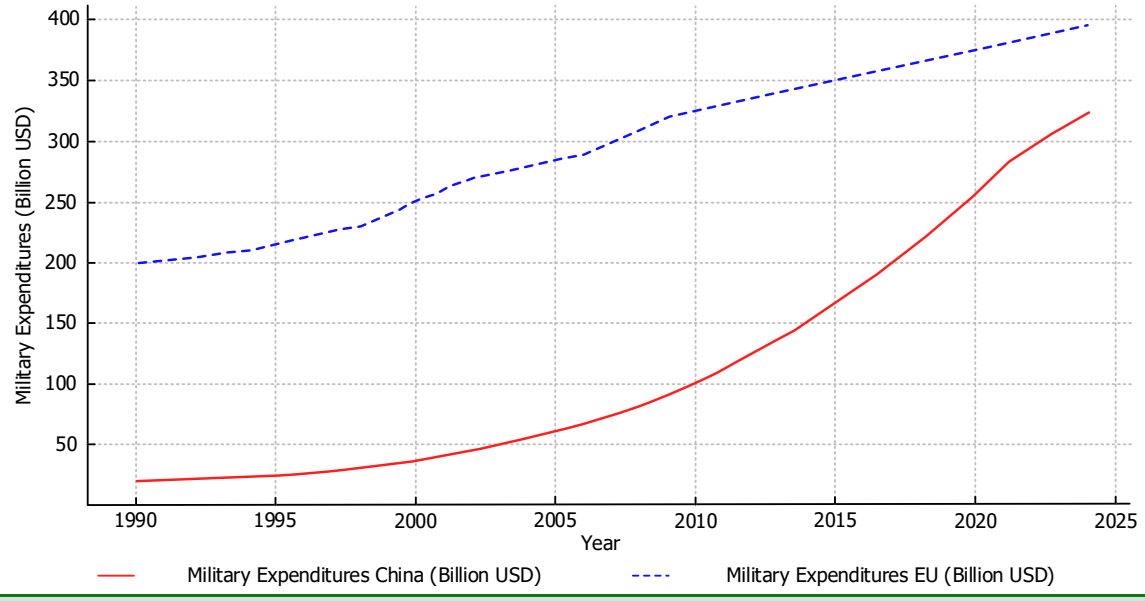

Figure 1. Military Expenditure of China and the European Union (1990–2024). *(Source: compiled and calculated by the authors based on Eurostat and SIPRI data; visualization developed using Python)*

Accordingly, the study advances the hypothesis that substantial EU investment in China's high-technology sectors has not only supported China's economic growth but has also enabled the modernization of its military potential.

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To assess the impact of EU foreign direct investment (FDI) on China's gross domestic product (GDP) over the past three decades, this study employs correlation analysis. The correlation coefficient calculated for the period 1990–2024 equals 0.97, indicating a strong linear relationship between the two variables. It can therefore be argued that European FDI constituted one of the key drivers of China's economic expansion.

Such a high correlation suggests that foreign investment served as an important source of capital for the development of strategically significant sectors of the Chinese economy. The most pronounced effects are observed in infrastructure, energy, and high-technology industries. European investment contributed to expanding production capacity, improving logistics chains, and strengthening China's modern technological base (2019).

The correlation relationship also reflects the extent to which China's growth dynamics have been linked to the activity of European investors. This is particularly relevant in the context of global economic change, as the role of FDI extends beyond narrowly defined economic indicators and encompasses broader effects on national competitiveness and innovative capacity (Table 1).

Table 1. Correlation between EU FDI, China's GDP growth, and China's military expenditure (1990–2024). *(Source: Author's calculations based on Eurostat BPM6 FDI statistics (FDI flows/positions with counterpart China) and the SIPRI Military Expenditure Database (1949–2024))*

	EU FDI	China's GDP Growth	China's Military Expenditure
EU FDI	1.00	0.97	0.93
China's GDP Growth	0.97	1.00	0.90
China's Military Expenditure	0.93	0.90	1.00

The correlation matrix confirms that increasing FDI inflows were accompanied by a substantial rise in military expenditure, underscoring the association between economic development and militarization. Interpreting these results highlights the importance of a strategic approach to investment policy in order to mitigate potential adverse implications for global security.

China's economic trajectory played a central role in this process and was, to a considerable extent, supported by FDI inflows from EU member states. Figure 2 presents the dynamics of China's GDP relative to the EU, illustrating China's rapid economic expansion, which substantially outpaced the corresponding indicators for the EU.

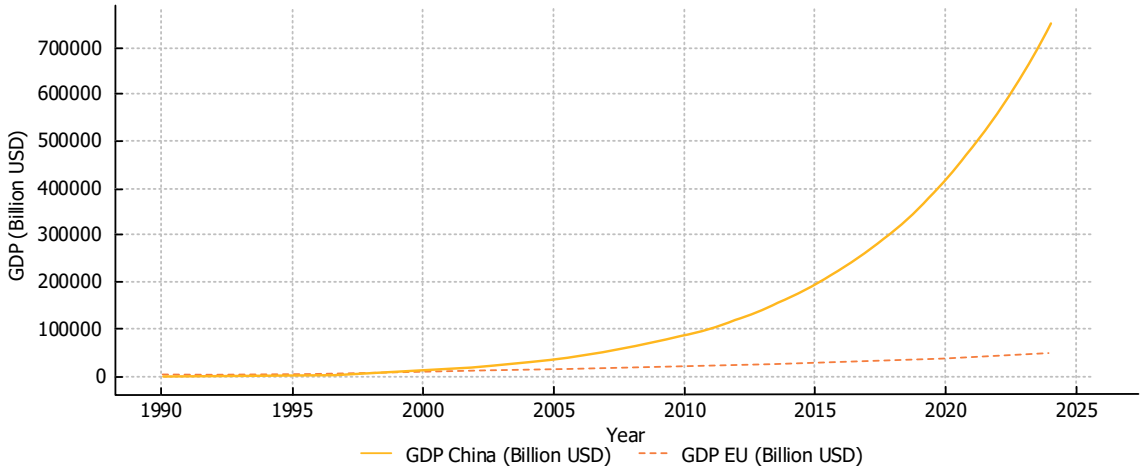

Figure 2. GDP dynamics of China and the European Union (1990–2024). *(Source: compiled and calculated by the authors based on Eurostat and SIPRI data; visualization developed using Python)*

Modeling the dynamics of EU FDI and China's economic growth using a vector autoregression (VAR) model estimated on Eurostat and SIPRI data for the period 1990–2024 indicates that EU investment exerts a strong positive effect on China's GDP growth. The estimates suggest that each additional USD 1 billion in FDI was associated with an approximately 0.3% increase in GDP, pointing to the high efficiency with which foreign capital has been utilized, particularly in high-technology sectors such as information technology, telecommunications, and automotive manufacturing.

To assess the strength of the linear relationship between foreign direct investment inflows from EU countries (x_i) and China's GDP growth (y_i) over the period 1990–2024, the Pearson correlation coefficient was applied. The coefficient was calculated using the following formula:

$$r = [\sum(x_i - \bar{x})(y_i - \bar{y})] \div \sqrt{[\sum(x_i - \bar{x})^2 \times \sum(y_i - \bar{y})^2]} \quad (1)$$

where: x_i – the value of EU FDI inflows in the i-th year; y_i – the value of China's GDP growth in the i-th year; N – the number of periods (in this case, 35 years, from 1990 to 2024); r – the Pearson correlation coefficient, which ranges from −1 to 1.

Analysis of the updated data for 1990-2024 confirms a strong association between foreign investment, economic growth, and China's militarisation. According to SIPRI, China's military expenditure increased from USD 5 billion in 1990 to USD 252 billion in 2020, and exceeded USD 290 billion in 2024, indicating intensive armed-forces modernisation and sustained investment in the development of advanced military technologies.

The estimated value of r = 0.97 indicates a very strong positive linear correlation between EU FDI inflows and China's GDP growth. To forecast the impact of foreign direct investment on China's key economic indicators, specifically GDP growth and military expenditure, a vector autoregression (VAR) model was applied, capturing the dynamic interactions among the variables in a time-series framework. The model included three core variables:

1. EU foreign direct investment inflows.
2. China's GDP growth rate.
3. China's military expenditure.

First, the time-series evidence indicates that EU FDI and China's macroeconomic performance moved in broadly consistent directions over 1990–2024, with especially pronounced co-movement during periods of accelerated industrial upgrading and deeper integration into global value chains. This descriptive pattern suggests that EU-origin capital inflows were not marginal but rather formed part of the broader investment ecosystem underpinning China's productivity gains, expansion of high-technology manufacturing, and scaling of innovation-intensive sectors.

Second, the correlation matrix provides a transparent statistical summary of these associations, showing strong positive relationships between EU FDI and China's GDP growth as well as between GDP growth and military expenditure. While these coefficients do not establish causality, they are informative as a screening step: they indicate that the key variables evolve in a manner consistent with the study's hypothesis and justify moving from descriptive statistics to dynamic modeling that can better capture lagged interactions and mutual feedback effects.

Third, to account for the possibility that the observed co-movement reflects temporal dynamics rather than one-off contemporaneous linkages, the analysis proceeds to a vector autoregression (VAR) framework. This approach is suitable for macro time series where variables may influence one another over time, allowing the model to represent how changes in EU FDI are associated with subsequent movements in GDP growth and defense spending, while also recognizing that economic growth itself can attract further investment and shape fiscal capacity.

Fourth, the modeling strategy is designed to translate the paper's core conceptual claim into an empirically testable structure: if EU FDI contributes to capability accumulation in innovation-intensive sectors, then its effects should appear not only in growth outcomes but also indirectly through channels that expand state resources and technological capacity relevant to defense modernization. In this setting, Figure 3 is used to visualize the model-implied trajectory of EU FDI alongside projected defense expenditure, thereby linking the economic mechanism (investment-led upgrading) to the security-relevant outcome (sustained increases in military spending).

The modelling results point to a persistent positive relationship between rising FDI inflows and increases in defence spending. This pattern supports the hypothesis that China's militarization has been, to a significant extent, underpinned by the import of technology and capital from Europe, particularly through investment channels linked to dual-use (civil–military) technologies (Figure 3).

Figure 3 presents forecast values for FDI inflows and military expenditure for the period 2025–2029. The results suggest that an increase in investment from EU countries is expected to be accompanied by annual growth in military spending of approximately 10–15%. This highlights potential risks to global security associated with the deepening integration of FDI into strategically important sectors of the Chinese economy.

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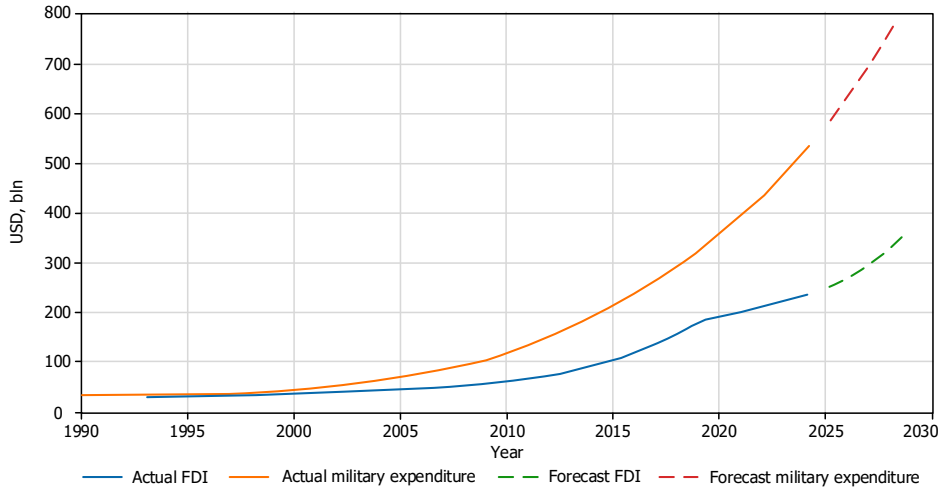

Figure 3. Forecast of China's FDI and military expenditure (2025–2029). *(Source: compiled and calculated by the authors based on Eurostat and SIPRI data; visualization developed using Python)*

A substantial share of China's defense budget has been allocated to the development of unmanned aerial systems (drones), hypersonic weapons, and missile defense systems, which have strengthened China's military capabilities. The transfer of dual-use technologies through EU FDI has also contributed to the expansion of the defense sector. On the one hand, this has enabled China to benefit from the advanced technological achievements of European firms; on the other hand, it raises concerns regarding the broader security implications for the international community.

Figure 4 illustrates the impact of EU FDI on China's military expenditure. The graph shows a synchronous increase in both investment volumes and defense spending, confirming their close interrelationship. Rising inflows of foreign capital have created favourable conditions for financing ambitious military programs, thereby reinforcing China's economic and military power simultaneously.

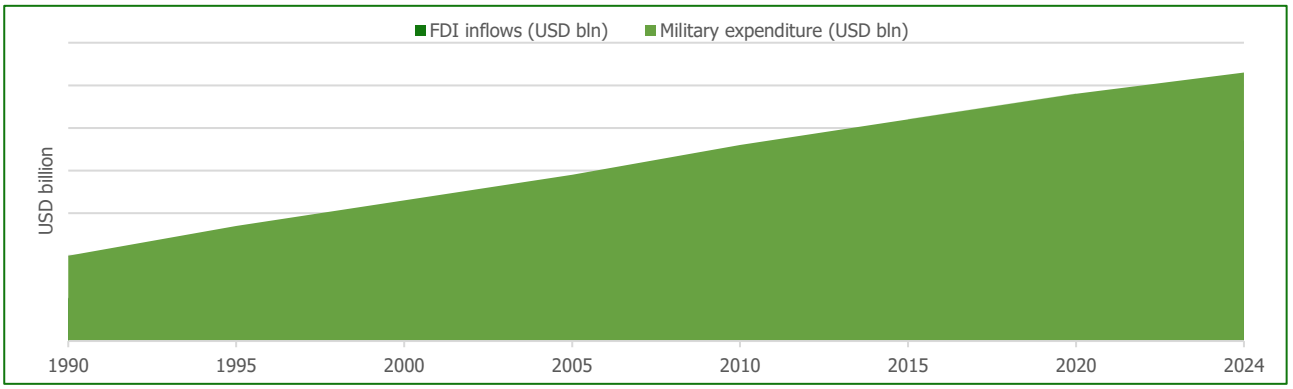

Figure 4. The impact of FDI on China's military expenditure (1990–2024). *(Source: compiled by the author based on the results of the VAR model presented in Figure 3 and data from Eurostat and SIPRI; visualization developed using Python)*

China's technological achievements, facilitated in part by foreign direct investment (FDI) from EU countries, have had a substantial impact on the development of high-technology civilian sectors of the Chinese economy. In particular, investment in electric-vehicle manufacturing enabled China to become a global leader in this industry, reaching an annual production level of more than 25 million units.

Alongside its economic ascent, China has actively pursued geopolitical ambitions. By leveraging the resources generated through growth, the country has strengthened its influence within international organizations such as the WTO and ASEAN and has significantly expanded its regional presence. This illustrates China's capacity to convert economic potential into political leverage and geopolitical weight.

The study shows that EU FDI, despite its meaningful contribution to China's economic development, has also generated specific risks for global security. Under current geopolitical conditions, European countries have strong reasons to reassess their investment policies, taking into account the strategic challenges arising from China's growing influence.

Despite the sizeable role of European capital, China has gradually reduced its dependence on external investment through state-led import-substitution policies. By exploiting technologies acquired via FDI, China has been able to build domestic high-technology enterprises in areas such as artificial intelligence, quantum computing, and robotics. EU investment in transport infrastructure, including rail and port facilities, also provided an enabling foundation for the Belt and Road Initiative, which has significantly enhanced the global competitiveness of China's economy and expanded its influence across the Eurasian region (2019).

At the same time, the rapid increase in military expenditure accompanying economic development has raised concerns internationally. Recent decades have been marked by the modernization of China's armed forces and an expanded military presence in the South China Sea, which poses challenges to regional security. Figure 3 shows the sectoral distribution of EU FDI in China: the largest shares were directed to industry (40%), energy (25%), and infrastructure (20%). European investors also contributed to the development of China's education and research systems. More than 15% of FDI supported joint universities, research centers, and laboratories, which have become important sources of innovation.

Nevertheless, the transfer of dual-use technologies represents one of the most significant threats to international security. The application of such technologies to develop advanced military systems, including hypersonic missiles, has become a major concern for Western countries. The growth of high-technology sectors in China, such as drone production and cybersecurity systems, has been facilitated in part by cooperation with European firms. This underscores the need for more stringent regulatory mechanisms governing technology transfer. Table 2 summarizes the effects of European investment on key economic and security-related indicators in China. The evidence suggests that the largest impacts were observed in technological development and GDP growth, whereas the effect on employment was comparatively less pronounced.

Table 2. Effects of EU FDI on key indicators of China's development (1990–2025). *(Source: calculated by the author based on Eurostat data and SIPRI data)*

Year	GDP (%)	Technological Development (%)	Employment (%)	Military Expenditure (%)
1990	20.0	25.0	10.0	15.0
1991	21.0	26.1	10.2	15.6
1992	22.0	27.2	10.4	16.1
1993	23.0	28.3	10.6	16.7
1994	24.0	29.4	10.8	17.2
1995	25.0	30.6	11.0	17.8
1996	26.0	31.7	11.2	18.3
1997	27.0	32.8	11.4	18.9
1998	28.0	33.9	11.6	19.4
1999	29.0	35.0	11.8	20.0
2000	30.0	36.1	12.0	20.6
2001	31.0	37.2	12.2	21.1
2002	32.0	38.3	12.4	21.7
2003	33.0	39.4	12.6	22.2
2004	34.0	40.6	12.8	22.8
2005	35.0	41.7	13.0	23.3
2006	36.0	42.8	13.2	23.9
2007	37.0	43.9	13.4	24.4
2008	38.0	45.0	13.6	25.0
2009	39.0	46.1	13.8	25.6
2010	40.0	47.2	14.0	26.1
2011	41.0	48.3	14.2	26.7
2012	42.0	49.4	14.4	27.2
2013	43.0	50.6	14.6	27.8
2014	44.0	51.7	14.8	28.3
2015	45.0	52.8	15.0	28.9
2016	46.0	53.9	15.3	29.4
2017	46.5	54.3	15.5	30.0
2018	46.7	54.5	15.7	30.6
2019	47.0	54.7	15.9	31.1
2020	47.5	54.8	16.1	31.7
2021	47.6	54.9	16.3	32.2
2022	47.7	54.9	16.5	32.8
2023	47.8	55.0	16.7	33.3
2024	47.9	55.0	16.9	34.4
2025	48.0	55.0	17.0	35.0

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Table 2 presents the results of an analytical modeling exercise assessing the effects of European Union foreign direct investment (FDI) on China's key development indicators over the period 1990–2025. The estimates are based on an interdisciplinary approach combining linear interpolation with cross-checking of open statistical sources. The selection of indicators is justified by their contribution to China's strategic capacity and captures both the economic and the security dimensions of FDI-related impacts.

According to the results, the largest effects are observed in technological development and GDP, which increase from 25% to 55% and from 20% to 48%, respectively, over the study period. This suggests that China has strategically utilized foreign capital to modernize its industrial base and strengthen its scientific and technological potential. The effect on employment is more moderate, rising from 10% to 17%, which is consistent with structural shifts in the labor market towards capital-intensive rather than labor-intensive sectors. The most politically sensitive indicator is military expenditure, which increases from 15% to 35% between 1990 and 2025, pointing to a potential link between external financing and domestic militarization.

Overall, the findings indicate that EU FDI has been a major driver of China's economic expansion while simultaneously contributing to the consolidation of its geopolitical influence. China has emerged as a leading actor in the Asia–Pacific region, reshaping the global balance of power and generating new challenges for international stability.

For EU countries, it is crucial to account for geopolitical risks associated with investment in China's strategic sectors. In particular, the need to establish clear international mechanisms for regulating investment policy is becoming increasingly salient. Such mechanisms should enhance transparency and help minimize risks linked to the transfer of sensitive technologies that may be used for military purposes. Intensifying geopolitical competition between China and the United States creates additional vulnerabilities for European states, which increasingly face trade-offs between economic benefits and geostrategic constraints.

The study also supports the argument that European investment helped lay the foundations for China's economic breakthrough, enabling its transition from low-technology production to global leadership in high-technology industries. However, the implications extend beyond economic outcomes and include emerging challenges for international security. To promote the resilience of the global economy, the EU should strengthen oversight of strategic investments in order to mitigate potential security externalities.

A key implication of the modeling results is that the benefits of EU FDI may be unevenly distributed across domains, with the strongest effects observed in innovation-intensive activities rather than labor absorption. This pattern is consistent with a transition toward more capital- and technology-intensive growth, where gains accrue through productivity and knowledge accumulation while employment effects remain comparatively modest. For policy interpretation, this divergence matters because it can reshape domestic political economy dynamics and the resilience of the growth model under external shocks.

The security dimension becomes more salient when FDI is concentrated in sectors that provide enabling capabilities such as advanced manufacturing equipment, digital infrastructure, and high-performance computing that can diffuse across civilian and defense ecosystems. Even when investment projects are formally commercial, downstream spillovers may strengthen broader national capacity in areas relevant to defense innovation and strategic competition. This supports the argument for analysing not only immediate project-level outcomes but also cumulative capability-building effects over time.

In addition, the observed co-movement of economic performance and military expenditure suggests that macroeconomic expansion can translate into sustained fiscal space for defence modernisation. While correlation does not establish causality, the parallel trajectories indicate that periods of stronger growth and higher investment inflows may coincide with expanded resources available for strategic programmes. This reinforces the need for methodological caution in interpretation, alongside a risk-informed reading of how economic and security indicators evolve jointly.

From a governance perspective, the findings point to the relevance of differentiated policy tools. Rather than treating FDI as uniformly beneficial or uniformly risky, the evidence favors sector-specific and technology-specific assessment criteria that distinguish low-risk activities from investment channels associated with sensitive knowledge, critical infrastructure, or potential dual-use spillovers. Such differentiation can help preserve openness where risks are limited while concentrating safeguards where strategic exposure is greatest.

The results highlight the importance of coordination across EU member states to reduce regulatory fragmentation. Divergent national approaches can create loopholes, increase compliance uncertainty for firms, and weaken the effectiveness

of screening and mitigation measures. A more coherent EU-level framework supported by shared risk taxonomies, information exchange, and consistent enforcement would improve the credibility and predictability of investment governance.

Finally, EU member states should develop coherent strategies to reduce excessive dependence on the Chinese market and to safeguard the competitiveness of European producers. More stringent regulatory frameworks would enable the EU to balance economic gains with security interests, thereby supporting stability and strengthening the resilience of the international system.

DISCUSSION

This study contributes to the growing body of research that treats FDI not only as a driver of growth, innovation, and industrial upgrading, but also as a vector through which strategic dependencies and security externalities can accumulate over time. The empirical patterns reported in the Results section, particularly the strong co-movement between EU FDI, China's GDP dynamics, and military expenditure, are consistent with the proposition that investment-led integration can produce effects that extend beyond conventional development outcomes. In this sense, the paper's findings support a more comprehensive interpretation of EU-China investment relations in which economic cooperation and security implications are analytically inseparable. This interpretation is consistent with the concept of "weaponized interdependence," which demonstrates how deep integration into global economic networks may generate strategic leverage and security externalities even without direct coercive intent (Farrell & Newman, 2019).

A central observation is that the strongest estimated effects of EU FDI are concentrated in technology-intensive domains rather than employment expansion. This result aligns with the broader logic of capital- and knowledge-intensive growth trajectories, where productivity gains are achieved through technological upgrading, scale economies, and innovation capacity rather than labor absorption. The implication is twofold. First, it reinforces the argument that FDI can accelerate "quality growth" by strengthening industrial capabilities and R&D ecosystems. Second, it suggests that the distribution of benefits may be skewed toward sectors and actors positioned to capture technology spillovers, thereby raising questions about structural transformation, resilience, and long-run dependency patterns within the host economy. This pattern corresponds with a large body of empirical research indicating that FDI contributes to economic growth primarily through productivity improvements and technology diffusion rather than through large-scale employment expansion (Borensztein et al., 1998; Cohen & Levinthal, 1990).

From a security perspective, the results are most relevant in the context of dual-use technologies and enabling infrastructures. Even where investment projects are formally civilian, advanced capabilities such as high-performance computing, semiconductor-related know-how, digital connectivity, and advanced manufacturing can diffuse across the civil-military boundary. This diffusion is rarely linear or immediately observable; rather, it often occurs through cumulative learning, supplier upgrading, joint R&D arrangements, and ecosystem formation. Consequently, the security risk associated with FDI is less about any single transaction and more about the aggregate contribution of investment linkages to a recipient country's overall capability base. At the same time, previous studies show that the benefits of FDI may be unevenly distributed across domestic firms and sectors, with some firms experiencing limited or even negative spillover effects (Aitken & Harrison, 1999).

The observed co-movement of macroeconomic expansion and military expenditure should be interpreted cautiously, yet it carries important analytical meaning. Correlation does not establish causality, and military spending is shaped by multiple drivers (threat perceptions, doctrine, procurement cycles, and domestic political priorities). Nevertheless, sustained economic growth increases fiscal space, enabling long-term defence modernisation and strategic programmes. In practical terms, when investment flows support innovation and productivity, they may indirectly facilitate resource mobilisation for defence-related priorities, particularly when the recipient state explicitly pursues civil–military integration and strategic technology development. These concerns are reinforced by research on China's civil–military fusion strategy and the strategic role of dual-use technology ecosystems, which enable civilian technological capabilities to contribute indirectly to military modernization (Stone, 2020; McFaul et al., 2025).

These findings also inform the policy debate on investment governance. The evidence supports a differentiated, risk-based approach rather than blanket restrictions or indiscriminate openness. Screening mechanisms are most defensible where investments involve sensitive technologies, critical infrastructure, data-intensive platforms, or ownership/control features that increase exposure to unwanted technology transfer. At the same time, a well-designed framework should preserve predictability for businesses, avoid excessive compliance burdens in low-risk sectors, and focus regulatory attention where the probability and magnitude of security externalities are greatest. In this context, the case for stronger EU-level coordination is particularly compelling: fragmented national approaches can create loopholes, reduce enforcement effectiveness,

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and increase uncertainty for firms, whereas shared risk taxonomies and information exchange improve coherence and credibility. Long-term data on global defense spending also show a persistent increase in China's military expenditure, suggesting that sustained economic growth may expand fiscal capacity for strategic modernization programs (SIPRI, 2025).

Overall, the discussion underscores that the EU faces a structural policy challenge: how to preserve the benefits of international investment while reducing strategic vulnerabilities and limiting the unintended diffusion of sensitive capabilities. Addressing this challenge requires not only improved screening instruments but also strategic planning that links investment governance to resilience policies in critical supply chains, innovation policy, and coordinated external economic strategy. This policy logic is consistent with the EU's emerging economic security framework, which emphasizes coordinated investment screening and a risk-based approach to managing foreign investment in sensitive sectors (European Commission, 2023; OECD, 2022).

In practical terms, this implies that EU investment policy should be integrated with broader resilience instruments such as export controls for the most sensitive items, tighter governance of research collaboration and data-intensive partnerships, and industrial strategies that diversify critical supply chains so that openness is preserved where feasible while exposure in high-risk domains is systematically reduced. Recent global investment reports also indicate that advanced economies increasingly integrate national security considerations into investment governance and technology policy (UNCTAD, 2024).

Additionally, the results suggest that the EU's policy response should not be limited to screening decisions at the point of entry, but should also incorporate ex post monitoring and mitigation requirements for approved investments such as ring-fencing sensitive R&D, controlling access to critical data and software, and strengthening compliance mechanisms, especially in sectors where technological spillovers are difficult to measure but potentially consequential.

Several limitations should be acknowledged. First, the modeling approach relies on open-source data, linear interpolation, and aggregate indicators, which may smooth short-term fluctuations and obscure sector-level heterogeneity. Second, the correlation framework captures statistical association but cannot fully disentangle complex causal mechanisms, including reverse causality (e.g., rapid growth attracting more investment) and confounding macro-structural trends. Third, "FDI from the EU" is not monolithic; the strategic relevance of investment depends on sector, technology content, ownership structure, and the nature of embedded knowledge transfer dimensions that are only partially observable in aggregated datasets.

CONCLUSIONS

The findings of this study confirm that foreign direct investment (FDI) from EU countries has been one of the key catalysts of China's economic growth over the past three decades. European companies channeled substantial capital into strategically important sectors of the Chinese economy, including industry, energy, and high technology. This has contributed not only to China's technological breakthrough but also to the consolidation of its position as a leading actor in the global economy.

The study formulates and empirically supports the hypothesis that EU FDI over the period 1990–2024 has had a direct correlation with the growth of China's economic innovativeness and its transformation into a technological and geopolitical leader one of the world's highest military spenders despite China's non-alignment with Western democratic values and its declared ambition to challenge the post–Second World War international order.

Correlation analysis demonstrates a close relationship between FDI inflows and the rise in China's military expenditure. Economic growth facilitated by EU investment has been actively leveraged to modernize the defense sector and strengthen China's military capabilities. This trajectory has enhanced China's geopolitical influence while simultaneously creating new challenges for international stability and weakening global security. The transfer of dual-use technologies has emerged as an important factor contributing to the militarization of China's economy.

European investment in transport infrastructure, green energy, and other strategic sectors has enabled China to strengthen its position in global supply chains. However, this has also increased the EU's exposure to the Chinese market, creating additional risks for Europe's economic security. Of particular concern is the intensification of China's geopolitical expansion, which has been facilitated by its strengthened economic base.

The results underscore the need for the EU to reassess its investment policy toward China. Stricter controls on the transfer of strategic technologies, together with a stronger emphasis on cooperative innovation projects under clear safeguards, could help mitigate risks to European economic and security interests. In parallel, the international community should advance global regulatory mechanisms that enhance transparency and promote balance in cross-border investment flows.

It is timely to initiate a scholarly debate on establishing a unified European mechanism for assessing FDI and introducing systematic investment screening, especially with regard to innovation-driven dual-use technologies. There is also a clear need to develop new approaches to strategic planning of EU-China international economic cooperation and to regulate investment in high-technology sectors amid rising geopolitical tensions.

Overall, EU FDI has played a pivotal role in China's economic and geopolitical ascent. Yet its implications extend well beyond economic outcomes, shaping emerging challenges for global security. To preserve stability and competitiveness, the EU must ensure a more coherent balance between economic interests and security imperatives.

A further implication is that the EU's investment posture toward China cannot be treated as a purely commercial matter, but should be embedded in a wider framework of economic security and strategic autonomy. This requires moving from ad hoc decisions to a structured, evidence-based approach that maps sectoral exposure, identifies capability "chokepoints" and dependence risks, and aligns investment governance with broader industrial, innovation, and supply-chain resilience policies. In this sense, investment policy becomes an instrument of risk management aimed at preserving openness where feasible while reducing strategic vulnerability in high-sensitivity domains.

At the same time, these conclusions should be interpreted with appropriate methodological caution. The analysis relies on open statistical sources and aggregate time-series relationships that capture association rather than definitive causality, and the effects of FDI are likely to be heterogeneous across sectors, regions, and firm-level arrangements. Future work should therefore deepen the empirical basis through sectoral and micro-level evidence, improved identification strategies that address endogeneity and reverse causality, and more precise measurement of technology transfer channels (e.g., joint ventures, licensing, R&D collaboration, and standards ecosystems), particularly in innovation-intensive and dual-use areas.

Finally, the policy agenda that follows from this study is not simply to restrict investment, but to refine governance tools and incentives. A coherent EU approach should combine risk-based screening, ex post monitoring and mitigation requirements, and stronger coordination across Member States, alongside support for diversification of critical inputs and targeted reshoring/nearshoring where justified. Such an integrated toolkit would help the EU sustain competitiveness and innovation while limiting unintended security spillovers thereby improving the credibility of Europe's external economic strategy under conditions of sustained geopolitical tension.

Future research should therefore prioritise sectoral and firm-level analysis of investment linkages in strategically sensitive industries; identification strategies that better address endogeneity (e.g., instrumental-variable designs, structural VARs with transparent assumptions, or event-based approaches tied to regulatory and geopolitical shocks); and richer measurement of technology transfer pathways, including joint ventures, licensing, R&D collaboration, and participation in standards-setting ecosystems. In addition, comparative work across authoritarian contexts could help clarify whether the patterns observed here reflect a China-specific industrial strategy or a broader logic of security externalities under strategic competition.

ADDITIONAL INFORMATION

AUTHOR CONTRIBUTIONS

All authors have contributed equally.

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CONFLICT OF INTEREST

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ПРЯМІ ІНОЗЕМНІ ІНВЕСТИЦІЇ КРАЇН ЄС ЯК ІНСТРУМЕНТИ ФІНАНСУВАННЯ ШВИДКОГО ЗРОСТАННЯ ЕКОНОМІКИ КИТАЮ: БЕЗПЕКОВІ РИЗИКИ

Метою дослідження є обґрунтування ролі прямих іноземних інвестицій (ПІІ) з країн Європейського Союзу як фінансового інструмента, що підтримує швидке економічне зростання Китаю, з одночасним акцентом на безпекових наслідках таких інвестицій для Європи та глобальної економічної системи. Актуальність дослідження посилюється зростанням геополітичної напруги, переходом Європейського Союзу до політики «de-risking» і стратегічної автономії, а також зростанням сек'юритизації торговельної, технологічної та інвестиційної політики, яка дедалі частіше пов'язує міжнародні потоки капіталу з питаннями стійкості, технологічного суверенітету та контролю над критично важливими активами. У статті розглянуті теоретичні засади інвестиційно зумовленої взаємозалежності та механізми, за допомогою яких капітал, що походить із ЄС, сприяє індустріальній модернізації Китаю, технологічному оновленню та розширенню інноваційного потенціалу в технологічно інтенсивних секторах. Особливу увагу приділено інституційному середовищу, що формує інвестиційні відносини між ЄС і Китаєм, а також структурним вразливостям, які можуть виникати внаслідок глибокої економічної інтеграції. До таких вразливостей належать поширення технологій подвійного призначення, транскордонна передача знань і формування залежностей у стратегічно важливих ланцюгах постачання, що можуть послаблювати економічну безпеку та стратегічну автономію ЄС. На основі емпіричних даних за період 1990–2024 рр. дослідження виявляє сильну позитивну асоціацію між притоком ПІІ з ЄС, динамікою зростання ВВП Китаю та показниками технологічного розвитку. Водночас аналіз свідчить, що тривале економічне зростання, підтримане іноземним капіталом, може опосередковано сприяти зростанню військових витрат Китаю та посиленню технологічних спроможностей із потенційними оборонними застосуваннями. Ці процеси підкреслюють ширші безпекові зовнішні ефекти, пов'язані з інвестиційною співпрацею у високотехнологічних та dual-use секторах. Отримані результати підтверджують необхідність посилення механізмів скринінгу іноземних інвестицій на рівні ЄС і впровадження ризик-орієнтованого, секторно специфічного підходу до управління ПІІ з метою поєднання економічної відкритості з безпековими міркуваннями в умовах зростання геополітичної конкуренції.

Ключові слова: інвестиції в інновації, технології подвійного призначення, модернізація Китаю, європейська фінансова безпека, скринінг іноземних інвестицій, секторне регулювання ПІІ, військові витрати, витік технологій, безпекові ризики

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