Beyond investment screening

Expanding Europe's toolbox to address economic risks from Chinese state capitalism

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Expanding Europe's toolbox to address economic risks from Chinese state capitalism

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1 Introduction

The European Union (EU) and China have entered a new stage in their relationship. China now appears as an "systemic competitor" or even "systemic rival" in assessments by major European business federations and EU institutions, and the EU Commission has launched a work program to assess ways to deal with the country's economic impact on the EU.[1] There is a growing belief across Europe that the balance of challenges and opportunities China presents has shifted, and that European policy-making needs to adapt to new long-term challenges arising from the competition between economic systems.

Underpinning this reassessment is a recognition that core elements of China's economic policy continue to be fundamentally different from market-oriented principles and practices in the OECD world. These principles include the promotion of open and competitive markets, effective price systems, and clear boundaries for state interference in the economy.[2] Europe's permissive stance thus far was contingent on Chinese convergence with such liberal economic norms; and adjustment was the general trend in China after 1978. But in recent years, the trend has become less clear.[3] Unless major reform steps are taken soon, the view that China under Xi Jinping is diverging with advanced economy norms will be entrenched. Given China's size and weight in global product and service markets, its reversion to statist economic strategies (or even sluggish progress toward more liberal approaches) will have direct and increasing impacts on the sustainability of Europe's system.

Europe's policy instruments will need to be adapted to this new reality. Trade competition implications can be grappled with trade policy tools (though with limited efficiency), and the national security consequences of direct investment have been tagged for stepped-up screening at the border. But this leaves much unaddressed. As the EU Commission reviews "gaps" in EU policymaking and tools for dealing with China-related distortions,[4] this report takes stock of defensive measures in competition, anti-subsidy, public procurement and related policy fields that could help Europe deal with market distortions spilling over through growing Chinese investment and other commercial linkages with Europe.

1 European Commission and HR/VP contribution to the European Council "EU-China – A Strategic Outlook", 12 March 2019, https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf; Federation of German Industries (BDI), "Partner and Systemic Competitor How Do We Deal with China's State-Controlled Economy?", Policy Paper, 10 January 2019, https://english.bdi.eu/media/publications/#/publication/news/china-partner-and-systemiccompetitor.

2 OECD, Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business, OECD Publishing, 2012.

3 Asia Society and Rhodium Group, China Dashboard: Spring 2019 Update, report, Spring 2019, https://chinadashboard.asiasociety.org/china-dashboard/; Nicholas Lardy, The State Strikes Back: The End of Economic Reform in China? Peterson Institute for International Economics, 2019.

4 European Commission and HR/VP contribution to the European Council, "EU-China – A Strategic Outlook," 12 March 2019, https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf.

The "China challenge" is just one issue in an emerging debate about the need for a revision of Europe's competition and industrial policies.[5] Given the stakes, the discussion has the potential to become politicized and counter-productive. In order to identify impactful and cost-effective solutions to promote and defend Europe's ability to compete, current issues will need to be assessed objectively. This report contributes to framing the current debate by distinguishing between three critical yet sometimes entangled or competing policy objectives: (1) An effort to preserve free and healthy market competition in the EU in the interest of EU consumers; (2) A producer-oriented drive to promote a level global playing field for European firms; (3) A desire to maximize the long-term competitiveness of European companies, including through new forms of industrial policy.

As EU member states and the Commission think about new policy instruments, we argue that Europe should be cautious to avoid the non-market practices it objects to abroad. Europe's response needs to be first and foremost a positive agenda for member states and EU institutions to enable a thriving market environment that fosters innovation and growth. Policy responses should advance a robust liberalism that avoids damaging competition policies and market principles that have been the regulatory workhorses of most OECD market economies for decades.

This report is structured as follows: Part 2 describes China-specific competition and competitiveness challenges faced by the EU, including concerns related to China's economic model and specific channels, and how these create harm for European consumers and producers. Part 3 presents the result of a comprehensive stock-taking of possible policy responses. It includes a review of existing instruments that could either be reformed or used more forcefully to respond to China-related challenges, as well as novel options. It also assesses these instruments in terms of potential effect in dealing with Chinese distortions, ease or difficulty of reform in the European context, and implications for EU-China and transatlantic relations. Part 4 finally offers a series of recommendations for European stakeholders in the short- and medium-term.

5 See, for instance, ongoing debates on how competition and industrial policies should evolve in the digital age. See: European Political Strategy Centre, EU Industrial Policy After Siemens-Alstom, report, 2019, https://ec.europa.eu/epsc/sites/epsc/files/epsc_industrial-policy.pdf; Jacques Crémer, Yves-Alexandre de Montjoye and Heike Schweitzer, Competition Policy for the Digital Era, Luxembourg: Publication Office of the European Union, 2019, http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf.

2 China-related distortions and their effect on Europe

China made strides toward marketization after starting reforms in 1978, but the extent of the progress said as much about the dysfunctional command and control economy starting point than full convergence with OECD norms. China and Europe are far apart in terms of openness, market-orientation and the magnitude of state intervention. In the 40 years that EU-China economic links have developed, China has evolved from a trivial player to the world's second largest economy, from a primitive pre-industrial technology level to a technological powerhouse. Persistent systemic differences in economic policy-making that were tolerable in the past are now a profound challenge to EU consumers and producers.

These systemic differences – regardless of whether they are intentional designs or artifacts of an unfinished transition – have significant spill-over effects beyond China, and into the European economy. These include asymmetric market access conditions, distorted financing costs for Chinese companies, and pervasive interventions effecting input and operational costs to confer price advantages. This is alongside anti-competitive state intervention and guidance that lends itself to collusion, and other behavior among Chinese producers to the detriment of producers elsewhere and ultimately to consumers everywhere.

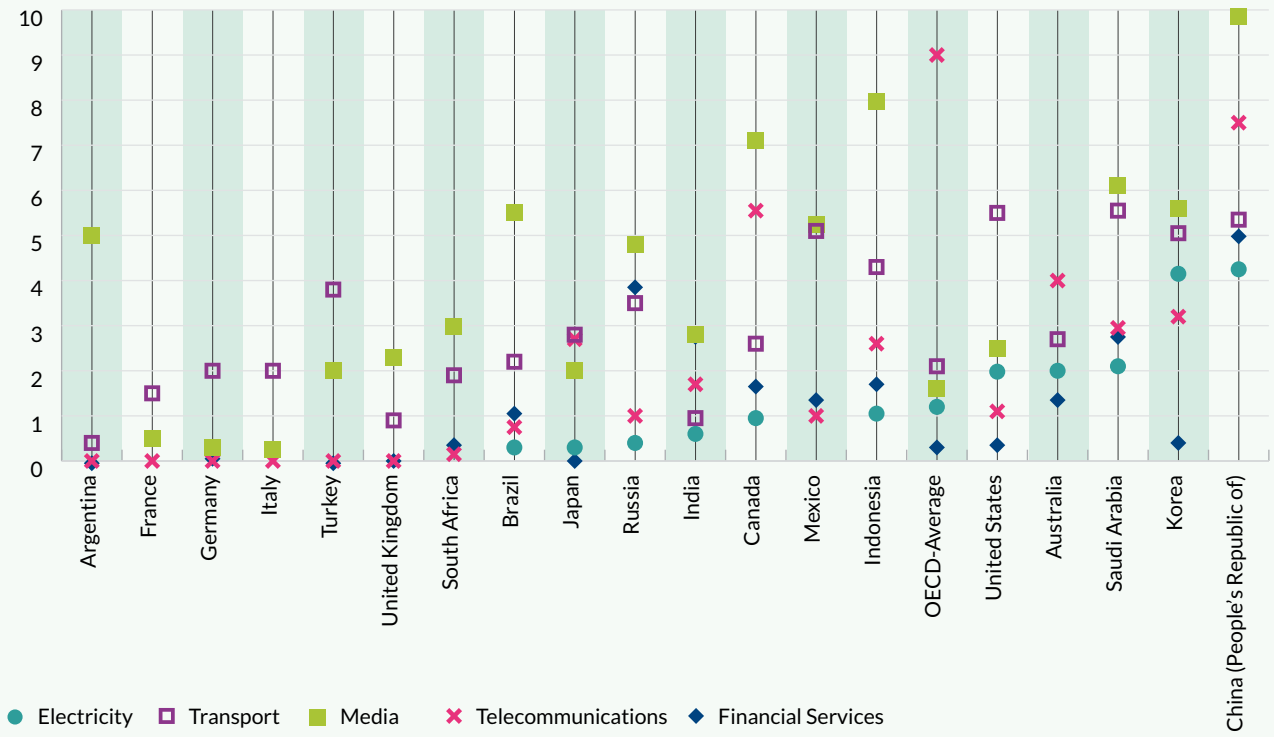
Competition-distorting asymmetries in trade and investment market access: Effective asymmetries in trade, investment and procurement market access between Chinese and foreign firms remain huge (Figure 1).[6] Beyond the border, formal and informal post-market entry barriers serve native firms and the state at the expense of Chinese consumers and foreign producers, including those from the EU.[7] These barriers have become more problematic with the growth of Beijing's ambition to guide its firms globally, and take on a new urgency due to doubts about China's reform agenda.[8] Beijing's new foreign investment law awaits implementation and did little so far to

6 See also: European Commission, Commission Staff Working Document on Significant Distortions in the Economy of the People's Republic of China for the Purposes of Trade Defense Investigations – SWD(2017) 483 final/2, 2017, http://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf; OECD, "OECD Services Trade Restrictiveness Index (STRI): The People's Republic of China," December 2018, https://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-country-note-china.pdf; Thilo Hanemann and Mikko Huotari, EU-China FDI: Working towards Reciprocity in Investment Relations, Rhodium Group and MERICS joint report, 2018, https://www.merics.org/en/papers-on-china/reciprocity; Martina F. Ferracane, Hosuk Lee-Makiyama and Erik van der Marel, Digital Trade Restrictiveness Index, European Centre for International Political Economy (ECIPE), April 2018, https://ecipe.org/dte/dte-report/.

7 According to the European Chamber of Commerce in China, barriers such as unequal access to subsidies, burdensome licensing requirements, lengthy administrative procedures, non-transparent procurement, national standards, and unpredictable enforcement of regulations continue to systematically distort the playing field for European companies in China. European Chamber of Commerce in China, European Business in China Position Paper 2018/2019, 2018, https://static.europeanchamber.com.cn/upload/documents/documents/Executive_Position_Paper_2018_2019[659].pdf.

8 For a tracking of China's economic reform progress, and notably the lack thereof in a series of policy fields, see: Asia Society and Rhodium Group, China Dashboard: Spring 2019 Update, report, Spring 2019, https://chinadashboard.asiasociety.org/china-dashboard/.

FIGURE 1 **FDI Restrictiveness in China, G20 countries and OECD average**
Electricity, Transport, Media, Telecommunications and Financial Services, 2017 or latest available, Index: 1=Closed/0=Open



Source: OECD.

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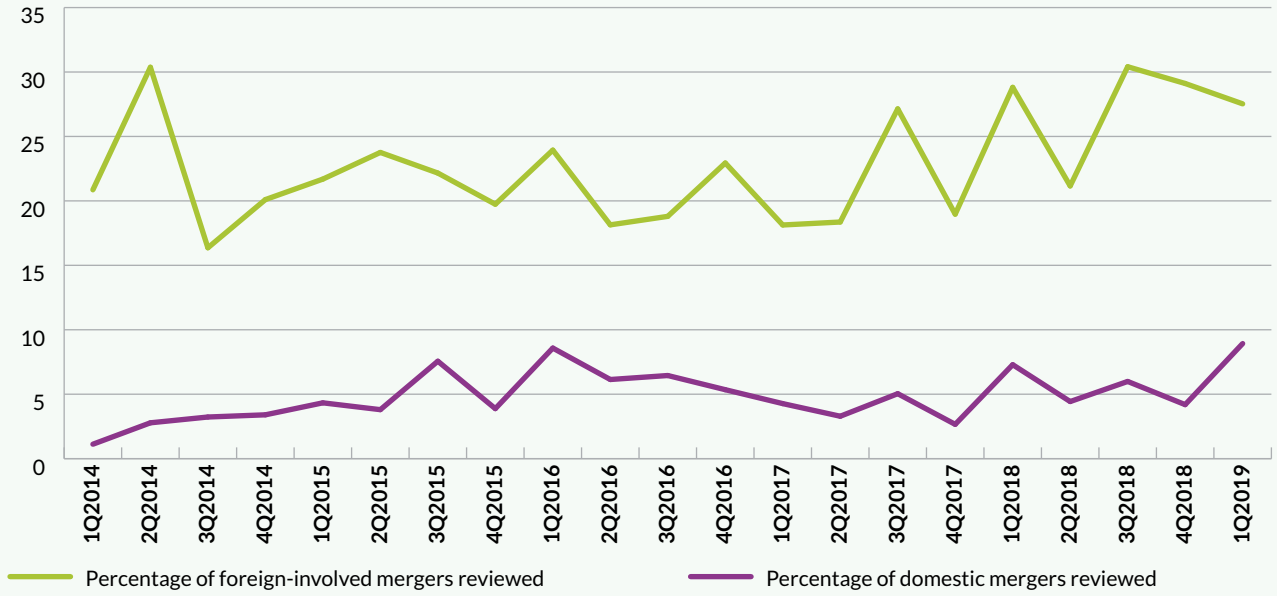
alleviate concerns around the lack of investment reciprocity in particular.[9] Shielded from the same competitive pressures faced by their foreign rivals, Chinese players with an edge at home serving consumers or government procurement contracts, and a level playing field abroad, have a non-market advantage in economies of scale and scope that can be detrimental for their rivals.

These playing field asymmetries go beyond unequal conditions at the border. The character of competition is shaped by systematic biases in favor of local players, particularly when it comes to China's competition policy regime. China is increasingly becoming a global competition policy power, but still mixes political guidance with commercial considerations in ways that now change market outcomes at home and abroad.[10] For example, 30 % of foreign firms involved in mergers with China-domiciled firms are called-in for a government review, while there is just a 6 % chance of review for mergers solely involving Chinese players (Figure 2). With Chinese authorities now frequently asserting their standing to rule on global mergers, the potential for nativist tendencies at home to be exported abroad is a rising concern (see Box 1, example 1).

9 European Chamber of Commerce in China, "European Chamber's Stance on the Foreign Investment Law," 15 March 2018, https://www.europeanchamber.com.cn/en/pressreleases/2937/european_chamber_s_stance_on_the_foreign_investment_law.

10 Henny Sender, "China's Antitrust Regime Comes of Age," Financial Times, April 1, 2018, https://www.ft.com/content/c64cc6fe-0c7c-11e8-839d-41ca06376bf2.

FIGURE 2 **Merger reviews in China, domestic vs. foreign-involved**
Percent of all mergers reviewed, for foreign-involved and domestic transactions



Source: Rhodium Group/Asia Society Policy Institute China Dashboard. Compiled from data from the Chinese Ministry of Commerce, Bloomberg, Rhodium Group.

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Such worries are further heightened by Beijing's recent threat, in the context of the US-China trade row, to publish an unreliable entities list based in part at least on China's anti-monopoly law.[11]

See Box 1, Example 1: China Uses Antitrust Enforcement as an Industrial Policy Tool.

Financing advantages: China's heavily state-led financial system comingles political objectives with market considerations. Markets are not the dominant factor in allocating the flow of capital or the manner in which risk is reflected in financing. Hence, the discipline that risk-adjusted capital costs brings to capitalism is not decisive in China, and by design, China's financial system allocates more weight to the interests of state-favored borrowing firms than to the interests of savers or other firms.[12] This is different to the calibration of interests in the advanced market economies. And despite talks of upping "competitive neutrality"

11 Xinhua, "China to Establish List of Unreliable Entities: MOC," Xinhua, 31 May 2019, http://www.xinhuanet.com/english/2019-05/31/c_138106866.htm.

12 An indicator of this is the cost of capital. In 2018, Hannah Anderson and Leon Goldfeld for example estimated that Chinese interest rates are about 300 basis point (bps) below benchmark, calculated as a theoretical, unsubsidized economic cost of capital for China based on economic forecasts and the evolution of the financial system. Hannah Anderson and Leon Goldfeld, The Cost of Capital in China's Changing Markets, J. P. Morgan Asset Management, The Future Path of Chinese Interest Rates, 2018, http://www.jpmorganassetmanagement.de/dms/JPM50455%20LTCMA%202018%20-%20CHINA.pdf. See also: Logan Wright and Daniel Rosen, "Politics in Command of the Financial System," in Credit and Credibility: Risks to China's Economic Resilience, report, CSIS Freeman Chair in China Studies, 77-92, https://csis-prod.s3.amazonaws.com/s3fs-public/publication/181003_CreditandCredibility_final.PDF?_WNSOvtP_qsWMtScnNdT.wxxnyEd1pUf; Lardy, The State Strikes Back, 102.

between private firms and SOEs in China over the past year,[13] Chinese policymakers have not yet walked the talk through noteworthy rebalancing measures.

The volume and terms of capital access for many systemically important Chinese enterprises means less worry about hard budget constraints, liberating them from the diligence and restraint demanded of their foreign competitors.[14] Even when Chinese credit rates are higher than rates abroad, rollovers to avoid insolvency are almost always the norm when central or sub-national SOEs are at risk.[15] In addition to softening the terms of nominally commercial credit, Beijing has also made available hundreds of billions of dollars in politically-defined credit facilities where the state bears the risk, such as the China Integrated Circuit Industry Investment Fund.[16]

Beyond the credit system, other channels deliver financial benefits to Chinese firms that distort competitive outcomes for other players and are increasingly threatening and unfair as the weight and spillover of China's choices abroad grows. These include the massive (though obviously unsustainable) role of local government fiscal outlays that accrue overwhelming to local favorites. National and sub-national subsidies are equally important, including general subsidies that may ostensibly be WTO compliant but which practically are not available to all companies equally, as well as specific sectoral or investment subsidies.[17] It is too soon to be certain which of these President Xi had in mind when he pledged in April 2019 "to clean-up and abolish anti-competitive, market-distorting, unreasonable subsidies, regulations and practices".[18] It has required herculean effort just to put these issues on the agenda. The problem is that the distorting effect of subsidies is existential now that China is a $13 trillion economy, and that the credibility of Beijing's promises to be convergent toward advanced economic conventions of comity and evenhandedness has eroded.

This panoply of financing benefits empowers Chinese companies with advantages over foreign competitors not only at home but also when they engage in foreign takeovers, with relative disregard for commercial risks, allowing them to

13 For instance, at a meeting chaired by premier Li Keqiang in December last year, China's State Council said that enterprises of any size and ownership shall be treated equally, according to the principle of "competitive neutrality". China State Council, "Li Keqiang Chairs Executive Meeting of the State Council to Increase Support for the Private Economy and Small and Medium Enterprises" (李克强主持召开国务院常务会议部署加大对民营经济和中小企业支持等), 24 December 2018, http://www.gov.cn/premier/2018-12/24/content_5351724.htm.

14 The low cost of financing for central and local Chinese SOEs and their often unsustainable leverage ratio have been well documented. See: Margit Molnar and Jiangyuan Lu, State-Owned Firms Behind China's Corporate Debt, OECD Economic Department Working Papers No. 1536, 2019, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2019)5&docLanguage=En; Giovanni Ferri and and Li-Gang Liu, Honor Thy Creditors Beforan Thy Shareholders: Are the Profits of Chinese State-Owned Enterprises Real? MIT Asian Economic Papers vol. 9, no. 3, 2010, 50-71; Lardy, The State Strikes Back.

15 For instance, it is normal practice for local governments to pressure local lending institutions to keep supporting loss-making firms, since allowing these firms to fail would mean losing a source of tax revenue. Lardy, The State Strikes Back, 108.

16 It is telling that Bank of China advised its global investors that "Chinese Commercial Banking Law requires all commercial banks to take into account government macroeconomic policies in making lending decisions." Mark Wu, "The China Inc. Challenge to Global Trade Governance," 303.

17 In 2018 alone, China's central and local governments paid $22bn in corporate subsidies, which corresponds to a 14 percent year-on-year increase. Tom Hancock and Yizhen Jia, "China pays record $22bn in corporate subsidies in 2018," Financial Times, May 27 2019, https://www.ft.com/content/e2916586-8048-11e9-b592-5fe435b57a3b. In some sectors, financial and non-financial subsidies conferred a big cost advantage to Chinese producers, leading to massive capacity increases. OECD, Measuring Distortions in International Markets: The Aluminium Value Chain, 2019, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC(2018)5/FINAL&docLanguage=En.

18 Brenda Goh and Cate Cadell, "China's Xi Says Belt and Road Must Be Green, Sustainable," Reuters, 26 April 2019, https://af.reuters.com/article/worldNews/idAFKCN1S2063.

offer premiums for foreign assets if necessary.[19] These practices disfavor European companies as acquirers of firms and assets. And they can impact acquired European firms by distorting buyers' incentives and hence potentially impeding efficient and prudent management post-acquisition.[20]

See Box 1, Example 2: China Provides State-backed Financing for Strategic Takeovers.

Other input and operational cost advantages: Beyond financing, China's system distorts the cost of other inputs in ways harmful to European welfare.[21] These include cost advantages from underpriced intermediates (due to subsidies or overcapacity), land and energy; unnaturally low R&D costs thanks to lax IPR protection, subsidies, or residual laws encouraging tech transfers; and unsustainably low regulatory and compliance costs (for instance on environmental controls and labor standards).[22] Often encouraged or defined by industrial policy, these departures from normal market economy norms have not just been exceptional cases but are typical in China today even after 40 years of reform. This alters supply and demand disciplines and leads to capacity inefficiencies.

These systemic conditions frequently lead Chinese producers to export products at a price advantage, impacting European producers operating with market-normal cost structures and – sometimes – causing systemic harm to whole European industry clusters (see Box 1, Example 3).

Such distortions that create interim operating advantages for China-domiciled firms threaten to be even more problematic in data-reliant sectors and industries, and in the aspects of competition in traditional industries that are data-related. Preferential policies and strategic market restrictions including through cyber security regulations and data localization requirements lead to distortions in the availability, cost and access to data as a foundational production input.[23] Because of extreme returns to scale and network externalities, the privileges of Chinese digital firms can create lasting biases in global innovation dynamics, with implications for Europe's ability to develop innovative digital industries.[24]

19 A comparison between Chinese and European investors' behavior found that, over the period 2003-2013, the average premiums paid by Chinese companies were double the size of the European acquisition premiums for the similar target company in Europe. Laimutė Urbšienė et al., "Comparison of Premiums of Chinese and European Companies in Merger and Acquisitions in Europe," Organizations and Markets in Emerging Economies vol. 6, no. 2 (12), 2015, 67-102, http://www.om.evaf.vu.lt/cms/cache/RePEc_files/article_74.pdf.

20 For example, in 2013 the state-owned company Cnooc paid a 60 percent premium to buy Canada's oil firm Nexen. But after the $15bn deal, amid falling oil prices, the company decided to lay off hundreds of staff. Kynge and Mitchell, James Kynge and Tom Mitchell, "M&A: China's World of Debt," Financial Times, 11 February 2016, https://www.ft.com/content/4c9642f6-d0a9-11e5-831d-09f7778e7377.

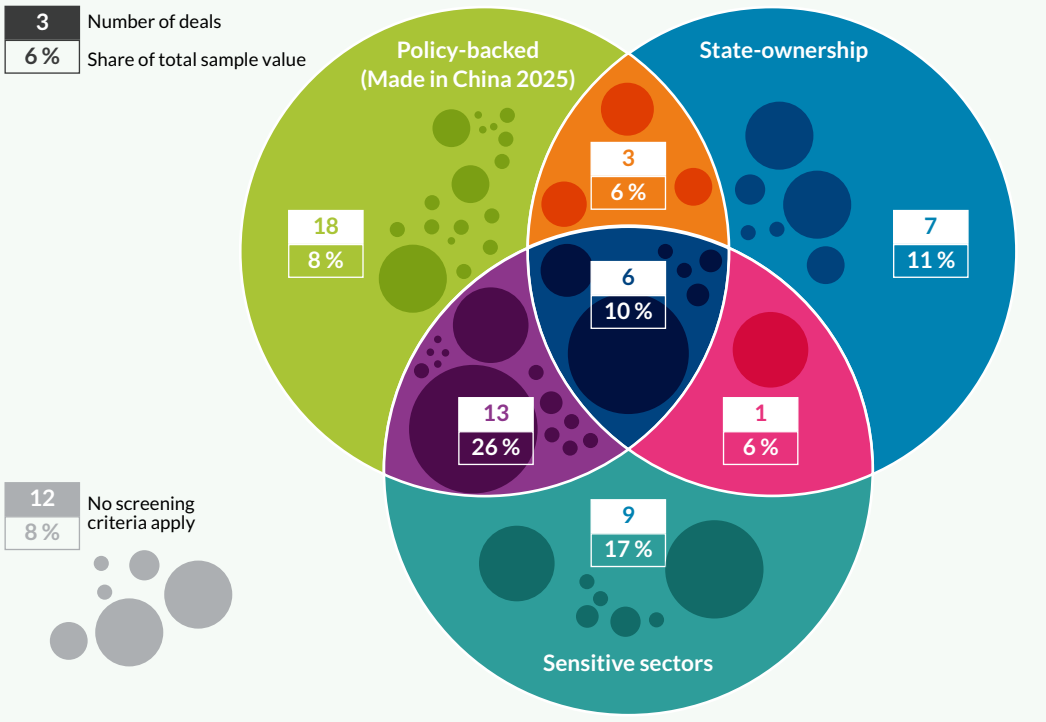
21 See deep-dive on production factor prices in: European Commission, Commission Staff Working Document on Significant Distortions in the Economy of the People's Republic of China for the Purposes of Trade Defense Investigations – SWD(2017) 483 final/2, 2017, http://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf.

22 Stephen Ezell and Nigel Cory, The Way Forward for Intellectual Property Internationally, Information Technology & Innovation Foundation, 25 April 2019, https://itif.org/publications/2019/04/25/way-forward-intellectual-property-internationally.

23 Chen Xinlei, "China's Digital Monopolies are Killing Competition and Need to Be Regulated," South China Morning Post, 19 August 2015, https://www.scmp.com/comment/insight-opinion/article/1850448/chinas-digital-monopolies-are-killing-competition-and-need; Samm Sacks and Manyi Kathy Li, How Chinese Cyber Security Standards Impact Doing Business in China, CSIC Briefs, August 2018, https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180802_Chinese_Cybersecurity.pdf?EqyEvuhZiedaLDFDQ.7pG4W1IGb8bUGF.

24 In the digital era, competition can be distorted in new and far-reaching ways that escape the scrutiny of regulators. For instance, a dominant digital platform which benefits from strong positive network effects and data access - which act as a significant barrier to entry - may acquires a small startup with a currently low turnover but a fast-growing user base and significant competitive potential. Cremer et al., Competition Policy for the Digital Era, 110-124.

FIGURE 3 **State-guidance: Chinese 2018 acquisitions of EU companies (over EUR 1mn) in sensitive sectors, policy-backed sectors, or by Chinese SOEs**



Source: Rhodium Group and Merics; Bubbles in the set "sensitive sectors" show acquisitions where the target is operating in one of the potentially sensitive sectors mentioned in the regulation. The "state ownership" set contains acquisitions where the ownership of acquirers and identified investors are at least 20 percent owned by Chinese government entities. The "policy-backed" set contains transactions in industries mentioned in or linked to China's "Made in China 2025" plan. Bubbles outside of all sets do not match any of these criteria.

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See Box 1, Examples 3, 4 and 5: China's "Solar Industry Pattern" as a Global Strategy; China-Affiliated EU Businesses Can Channel China-specific Distortions, Bending Competition in the Digital Age.

State guidance and collusion: A prevalent aspect of China's system, of its external commercial policies and of its industrial policy designs is to avoid "unhealthy" or "unnecessary" competition. This is exemplified in the Made in China 2025 strategy and associated plans, which promote selected global Chinese industries and players.[25] More broadly, global concentration has been increasing quickly due to Chinese firms. Between 2006 and 2014 alone, global concentration rose in several industries where Chinese state-owned enterprises (SOEs) dominate. But such heightened concentration

25 Wübbeke et al., Made in China 2025: The Making of a Hi-Tech Superpower and Consequences for Industrial Countries, MERICS Papers on China no. 2, 2016, https://www.merics.org/en/papers-on-china/made-china-2025.

did not correlate with greater efficiency.[26] The ultimate step to avoid "unnecessary competition" is recent mega-mergers engineered among central SOEs.[27] Such concentration of market power is certain to distort the distribution of rent between producers and consumers absent a powerful and even-handed government function to constrain firms with monopoly or oligopoly power.

That spirit of mistrust toward competition combined with pervasive state-ownership and guidance lends itself to unusually high levels of coordination among Chinese players, with non-commercial considerations as a focus.[28] This reality is highly problematic from the European perspective. Political party committees are by design present in Chinese firms to affect purposes not emphasized by corporate boards of directors;[29] European firms rely solely on the latter to enshrine governance. And given Beijing's stated goal of avoiding competition among Chinese firms in bidding to acquire a foreign firm (for example),[30] and the cross-firm presence of the Party,[31] the burden lies heavily on China to show how collusion will be prevented.

Europe must be alert to size effects of China's state guidance, and to the likelihood that Chinese firms are not as independent of their governments or one another as market economy firms are. State-driven coordination opens the way to harmful behaviors including price guiding, abuse of dominant position, and collusion in cartels. These concerns are not limited to state firms, they concern private firms as well.[32] Coordinated pricing and bargaining power can create further distortions and unfair competition for European business, as a sector-wide or even cross-sectoral phenomenon.

See Box 1, Examples 6, 7 and 8: Increased Chinese SOEs Concentration Affects Global Competition Dynamics, Guided Acquisitions, China's Export of Non-Market Practices.

26 Caroline Freund and Dario Sidhu, Global Competition and the Rise of China. Working Paper 17-3, Peterson Institute for International Economics, 2017, https://piie.com/publications/working-papers/global-competition-and-rise-china.

27 Sean O'Connor, SOE Megamergers Signal New Direction in China's Economic Policy, U.S.-China Economic and Security Review Commission, Staff Research Report, 24 May 2018, https://www.uscc.gov/sites/default/files/Research/SOE%20Megamergers.pdf.

28 The attempted takeover of German semiconductor equipment maker Aixtron by Fujian Grand Chip Investment Fund (FGC) serves as a good example for the intricate web of relationships behind some Chinese investments and the risks of collusion also associated with minority state ownership. Angela Huyue Zhang, "The Antitrust Paradox of China, Inc.," International Law and Politics vol. 50 (2017): 212-213; Wübbeke et al., Made in China 2025, 51-54.

29 Wendy Leutert, "Firm Control: Governing the State-Owned Economy under Xi Jinping," China Perspectives 1-2, 2018: 27-36, https://journals.openedition.org/chinaperspectives/7605; Rosen et al., Missing Link, 30-31; Sebastian Heilmann, "How the CCP Embraces and Co-Opts China's Private Sector," MERICS, 21 November 2017, https://www.merics.org/en/blog/how-ccp-embraces-and-co-opts-chinas-private-sector.

30 Information Office of the Ministry of Commerce od the People's Republic of China, "商务部和国资委联合召开 '加强对外投资合作和援外工作管理座谈会'," (Ministry of Commerce and SASAC Jointly Hold a 'Symposium on Strengthening Foreign Investment Cooperation and Foreign Aid Work Management'), MOFCOM, 23 August 2011, http://www.mofcom.gov.cn/aarticle/ae/ai/201108/20110807707765.html.

31 Curtis J. Milhaupt and Wentong Zheng, "Beyond Ownership: State Capitalism and the Chinese Firm," 03 Geo. L.J. 665, 2015, https://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1693&context=facultypub; Mark Wu, "The ‚China, Inc.' Challenge to Global Trade Governance," Harvard International Law Journal, Vol. 57, 1001-1063 (2016); Yasheng Huang, "State Capitalism in China," The Annual Proceedings of the Wealth and Well-Being of Nations vol. 8, 2015-2016: 19-49, https://www.beloit.edu/upton/assets/VOL_VIII.Huang.pdf.

32 A prominent example of government coercion of privately-owned companies is China's use of export restrictions of rare earths elements (REE) in 2010, which led to a huge increase in global REE prices and, consequently, a WTO dispute that China lost. The policy applied to state-owned and private firms alike. Keith Bradsher, "Amid tensions, China Blocks Vital Export to Japan," New York Times, 22 September 2010, https://www.nytimes.com/2010/09/23/business/global/23rare.html.

Observed patterns in Chinese policymaking require European action. Current policy and economic indicators point to continued structural divergence going forward. It is possible that China's leaders will respond to the evident need to rekindle marketization (as a result of elevated US and EU pressure) by introducing major structural reforms that address the systemic differences described above on an accelerated timetable. Yet a few recent developments do not paint an encouraging picture, including: The modesty of progress in critical EU-China negotiations (the EU-China BIT has been in negotiation for six years); key elements absent from China's domestic policy-making so far (the new FDI law adopted in March 2019 will only be a breakthrough if followed through with very robust implementing regulations and companion reforms); or the increased politicization of economic processes and commercial players (Beijing's upcoming unreliable entities list, and threat of rare earth export disruption, are two examples).[33] At China's scale and weight in marginal global growth, distortions and policy shortcomings that were once tolerable now are existential challenges for foreign counterparts.

Regardless of the underlying motives, and even under the best scenarios for a return to emphasis on reforms, existing market distortions harm EU producers, consumers, and economic models.

33 Qing Ying and Han Wei, "China Will Deliver Its Own Entity List Soon, Minister Says", Caixin Global, 14 June 2019, https://www.caixinglobal.com/2019-06-14/china-will-deliver-its-own-entity-list-soon-ministry-says-101426644.html.

BOX 1 EXAMPLES OF CHINA-RELATED MARKET DISTORTIONS AND THEIR SPILL-OVER EFFECTS

EXAMPLE 1 China Uses Antitrust Enforcement as an Industrial Policy Tool

Chinese antitrust authorities sometimes use merger reviews to facilitate domestic industrial policy objectives, at the expense of foreign competitors. In areas designated as economic priorities, Beijing has permitted mergers between domestic firms, while deterring similar ones among foreign businesses.

In 2014, the Chinese Ministry of Commerce (MOFCOM) rejected a proposed shipping alliance between Maersk, MSC, and CMA CGM (the "P3" network), on the grounds that it would undermine public interests in China, even after regulators in the US and the EU approved the merger (under certain conditions).[34] In 2016 however, MOFCOM approved a merger proposal from two state-owned shipping giants, China Ocean Shipping and China Shipping Company, to form COSCO Shipping.[35] COSCO would play a leading role in China's flagship Belt and Road Initiative (BRI).[36] It would also go on to take over Orient Overseas International (OCOL) in 2018 and replace CMA CGM, one of the merging parities in the P3 proposal that MOFCOM rejected, as the third largest ocean carrier in the world.[37]

When the two are in conflict, Beijing might prioritize industrial policy objectives over antitrust principles. Given that China's current mix of industrial policies focuses on reducing foreign dependence, regulators are incentivized to favor mergers that create Chinese national champions, while restricting consolidations among their foreign competitors. Such biased enforcement of merger control creates a discriminatory competition environment for foreign businesses globally.

EXAMPLE 2 China Provides State-backed Financing for Strategic Takeovers

Beijing often provides state-backed financing for SOEs' takeovers of strategic foreign assets, which not only puts other bidders at a disadvantage, but challenges the division between government and market globally.

In 2017, China National Chemical Corp. (ChemChina) acquired the leading Swiss agrochemical producer Syngenta. The $50 billion deal was partially backed by a $30 billion recourse loan, led by China's state-controlled CITIC Bank International. Bank of China, another major state-controlled bank, also purchased $10 billion of ChemChina perpetual bonds to improve liquidity conditions of the severely leveraged acquirer.[38]

The Syngenta deal was highly strategic, not only because ChemChina is a major central SOE that rotates senior executives into government positions, but also because Syngenta's portfolio of genetically modified crop seeds fits with the Chinese government's plans to increase the country's food security through self-reliance in grains and seeds.

State-financed SOE takeover risks politicizing some otherwise commercial transactions, and creates an unlevel playing field for other acquirers. And there is no guarantee that the highly leveraged Chinese bidders, although backed by state financial institutions initially, will be able to repay such financial backing, as the conditions for granting them were political in the first place.[39]

34 Richard Milne, "China Blocks Proposed three-way Shipping Alliance." Financial Times, 17 June 2014. https://www.ft.com/content/a9a188be-f60f-11e3-83d3-00144feabdc0.

35 Joanne Chiu & Costas Paris, "China Approves Merger of Cosco; China Shipping." Wall Street Journal, 11 December 2015. https://www.wsj.com/articles/china-approves-merger-of-cosco-china-shipping-1449834748.

36 Dustin Braden, "China Cosco Gets $26B for Belt and Road Initiatives." International Trade News, 13 January 2017. https://www.joc.com/international-trade-news/infrastructure-news/china-cosco-gets-26b-belt-and-road-initiatives_20170113.html

37 Port Technology, "COSCO Triples Market Share in Three Years." Port Technology, 01 August 2018. https://www.porttechnology.org/news/cosco_triples_market_share_in_three_years.

38 Alasdair Reilly, "Syngenta's $20 billion Acquisition Loan Launches." Reuters, 26 February, 2016. https://uk.reuters.com/article/us-loans-syngenta/syngentas-20-billion-acquisition-loan-launches-idUKKCN0VZ1C6?irpc=932.

39 James Kynge & Tom Mitchell, "M&A: China's World of Debt." Financial Times, 11 February 2016. https://www.ft.com/content/4c9642f6-d0a9-11e5-831d-09f7778e7377.

EXAMPLE 3 China's "Solar Industry Pattern" as a Global Strategy

Fueled by generous government support, overcapacity in China's exporting sectors often spills over to global markets. While overproduction is inefficient and bound to correct eventually, Beijing's willingness and ability to absorb economic losses in order to create national champions can destroy competitors elsewhere constrained by normal market economic norms.

Beijing started to subsidize solar power in 2009.[40] While government support for renewable energy is common globally, China's approach is more prone to overcapacity: cash subsidies overwhelmingly go to upstream producers instead of downstream installers or consumers, which incentivizes increases in supply capacity, without generating a matching domestic demand. As a result, China's share of global solar power capacity increased from 1 % in 2009 to 33 % in 2017, with all top eight solar PV producers in 2018 being Chinese.[41] To protect EU players, the EU imposed a price floor on Chinese imports in 2013–2018. And in 2018, Beijing began to dial back subsidies. Yet early support allowed Chinese players to become market leaders globally, with "significant negative effect on the financial and operational performance of European producers."[42]

The "solar power pattern" might not be economically optimal, but it delivers national champions that dominate global markets. There are signs that this pattern is playing out again, for instance, in the robotics, battery and e-vehicles markets. It demonstrates how Beijing's economic rationale can deviate from market norms, and the multi-level challenges it brings to the global trade and competition environment.

40 International Energy Agency & International Renewable Energy Agency, The Golden Sun Program, 2011. https://www.iea.org/policiesandmeasures/pams/china/name-24845-en.php?s=dHlwZT1yZSZzdGF0dXM9T2s.

41 YaleEnvironment360, "The World Added Nearly 30 Percent More Solar Energy Capacity in 2017." E360 Digest, 19 March 2018. https://e360.yale.edu/digest/the-world-added-nearly-30-percent-more-solar-energy-capacity-in-2017.

42 European commission, "Press release: EU imposes provisional anti-dumping tariffs on Chinese solar panels, http://europa.eu/rapid/press-release_IP-13-501_en.htm.

EXAMPLE 4 China-Affiliated EU Businesses Can Channel China-specific Distortions

After being acquired by Chinese SOEs, some prominent European businesses, now financially and operationally linked to their Chinese parent entities, can become collateral damages in subsidy-related trade frictions. With state support, Chinese SOEs typically integrate their newly-acquired European assets along state industrial policy guidance, which can then lead to trade actions catching these European businesses in the crossfire.

In 2015 ChemChina acquired Pirelli, an Italian high-end tire maker, for 7.1 billion euros.[43] After the acquisition, ChemChina integrated Pirelli's industrial tire unit with its existing business lines, which export industrial tires to markets worldwide (including in the EU). However, the European Commission found that China provided state subsidies to the tires industry, and subsequently issued an anti-dumping ruling on Chinese truck and bus tires in 2018.[44] Pirelli, now considered a Chinese exporter by the European Commission, was also subject to the anti-dumping tariffs.

Chinese government support sweetened the initial transaction by offering financial premium. But it can become a double-edged sword for the acquired European business, as government support can also trigger trade actions against the business. This constitutes an additional layer of risk that is unique to SOE-involved acquisition.

43 Paola Arosio & Danilo Masoni, "ChemChina to buy Italian tire maker Pirelli in $7.7 billion deal." Reuters, 22 March 2015. https://www.reuters.com/article/us-pirelli-chemchina/chemchina-to-buy-italian-tire-maker-pirelli-in-7-7-billion-deal-idUSKBN0MI0PQ20150322.

44 Rubber & Plastic News, "European union issues definitive antidumping duties on Chinese truck, bus tires." European Rubber Journal, 23 October 2018. https://www.rubbernews.com/article/20181023/NEWS/181029990/european-union-issues-definitive-antidumping-duties-on-chinese-truck-bus-tires.

EXAMPLE 5 Bending Competition in the Digital Age

Chinese policies are also likely to threaten Europe's competitiveness in developing future industries, for example in the digital field. State policies encouraging outward FDI in emerging technologies mean that Chinese companies are reaping benefits from early research in Europe through acquisitions. For example, Chinese tech giants such as Alibaba are buying a host of European data analytics startups, most recently Germany's Data Artisans in 2019. And China's closed-up data market offers a clear advantage to Chinese digital players.

Data is of vital importance in the digital age, and with 20% of world population, China is a key market for building up digital scale. Yet features of China's cybersecurity regime restricts the competitiveness of non-Chinese businesses through onerous data localization requirements. Beijing is a strong advocate of a government-controlled approach to information security and "cyber sovereignty", which aims to restrain cross-border data flows.[45] It ultimately limits foreign businesses' ability to retrieve and manage data in China and puts them at a competitive disadvantage.

While there are other aspects of the data challenge, unequal data access will be the primary threat to market competition in the digital area.[46] China's techno-nationalistic approach to data might eventually create a distorted environment for digital competition.

EXAMPLE 6 Increased Chinese SOEs Concentration Affects Global Competition Dynamics

In areas identified as state priorities, Beijing actively pushes for market concentration — often in the form of mega-mergers between SOEs[47] — while market economies typically scrutinize such mergers in their jurisdictions to protect consumer welfare. Such differences create unequal market conditions in various markets and can result in competitive disadvantages for non-Chinese competitors.

In 2015, China merged its two rolling-stock giants, CNR and CSR, into a de facto rail monopoly, CRRC.[48] Chinese antitrust authorities did not oppose the merger. Enjoying various government support, CRRC brought in an annual revenue of 26 billion euros ($30 billion) in 2017, greater than Siemens, Alstom and Bombardier combined.[49] It has over 40% global market share in electric locomotives, and enjoys unchallenged domestic dominance.[50] In contrast, the European Commission antitrust authorities blocked a proposed merger between CRRC's two major global competitors, the railway divisions of Alstom and Siemens, in 2019. Although CRRC does not yet display a significant footprint in Europe, its competitive advantage vis-à-vis foreign peers is already visible in many third markets.

The gap between market economy norms and Chinese permissiveness around industry concentration creates a costly regulatory gap between Chinese companies and their competitors. Antitrust practices typically stay within national borders, yet companies increasingly compete beyond such borders. As Chinese SOEs become active players on the global stage, the competition-distorting effects of China's SOE coordination strategy will only be amplified.

45 Elliott Zaagman, "Cyber Sovereignty and the PRC's Vision for Global Internet Governance.," The Jamestown Foundation, Chia Brief vol. 18 (2018). https://jamestown.org/program/cyber-sovereignty-and-the-prcs-vision-for-global-internet-governance/.

46 Jacques Crémer; Yves-Alexandre de Montjoye; Heike Schweitzer, Competition policy for the digital era, Luxembourg: Publication Office of the European Union, 2019, http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf.

47 Sean O'Connor, SOE Megamergers Signal New Direction in China's Economic Policy, U.S.-China Economic and Security Review Commission, Staff Research Report, 24 May 2018, https://www.uscc.gov/Research/soe-megamergers-signal-new-direction-chinas-economic-policy.

48 David Briginshaw, CNR and CSR finalise merger to become CRRC, 2015. https://www.railjournal.com/financial/cnr-and-csr-finalise-merger-to-become-crrc/.

49 SCI MulticlientStudies "Worldwide Rolling Stock Manufacturers.," 2018. https://www.sci.de/fileadmin/user_upload/MC_Studien_Flyer/Flyer_MC_Worldwide_Manufacturers_2018_de.pdf.

50 Ibid.

EXAMPLE 7 Guided Acquisitions

Direct government financing of technology-seeking investment through strategic funds is becoming another important feature of China's overseas activities, though less detectable and more amorphous.[51]

Following the national plan to boost semiconductor self-reliance, China established a dedicated National Integrated Circuit (IC) Fund to support both domestic and overseas investments in semiconductors. The fund has a mixed ownership structure (the Ministry of Finance directly holds 36 %, while various SOEs and local government financial platforms hold the rest) and invests in a wide range of companies, domestic and foreign, through different types of financial arrangements. One year after its creation, takeover offers of semiconductor firms by Chinese companies jumped from less than $1 billion to $35 billion.[52] In 2016, the IC Fund became the third largest investor in Apex Technology, a Chinese investment consortium. Shortly after, Apex acquired US computer printer maker Lexmark International in an all-cash deal worth $3.6 billion, a 17 % premium on Lexmark's closing share price.[53]

Transactions generated by state-backed investment vehicles combine three problematic features: First, these funds can blur the line further in terms of state-ownership of Chinese outward transactions; second, state-backing for foreign acquisitions can distort the acquisitive playing field for non-Chinese players; and third, these transactions display a clear alignment with China's state-led ambitions in diverse technological sectors.

EXAMPLE 8 China's Export of Non-market Practices

The divergence between China's non-market economic practices and OECD norms can shield Chinese firms from antitrust actions in foreign jurisdictions. Anticompetitive practices at home can become a legal defense for Chinese exporters in antitrust litigations abroad, thus presenting legal and policy challenges in foreign jurisdictions.

From 2005 to 2018, plaintiffs representing US consumers sued a group of Chinese Vitamin C exporters for violating US antitrust law, by conspiring to fix price ("In re Vitamin C Antitrust Litigation").[54] In court, Chinese defendants used the "sovereign compulsion defense": They admitted to price-fixing but argued that it was compelled by the Chinese government. MOFCOM made a historic appearance in US court, supporting the defendants' claim by stating that it indeed ordered these exporters to fix prices, in order to "forestall potential market disorders". The US appellate court initially dismissed the case on comity grounds (accepting the defendant's reasoning to some extent), before the US Supreme Court later ruled in favor of the plaintiffs.

The Vitamin C case demonstrated how China's non-market practices can be "exported" globally. And the fact Beijing encourages cartel behavior challenges the interpretation of legal concepts such as sovereign compulsion and comity around the globe. It also reflects the lack of symmetry between China's economic practices and market economies.

51 The recent surge of Chinese global takeover offers in the semiconductor industry in particular points to the importance of Chinese government policies as a determinant of outbound investment flows in industries deemed strategic for national industrial policy objectives. See Thilo Hanemann and Daniel Rosen. 2016. Chinese Investment in the United States; Recent Trends and the Policy Agenda. RHG report prepared for the US-China Economic and Security Review Commission, 77–82.

52 See Thilo Hanemann and Daniel Rosen. 2016. Chinese Investment in the United States; Recent Trends and the Policy Agenda. RHG report prepared for the US-China Economic and Security Review Commission. https://rhg.com/research/chinese-investment-in-the-united-states-recent-trends-and-the-policy-agenda/.

53 Lexmark, "Lexmark announces completion of acquisition by Apex Technology and PAG Asia Capital.," Lexmark. 29 November 2016. https://newsroom.lexmark.com/2016-11-29-Lexmark-announces-completion-of-acquisition-by-Apex-Technology-and-PAG-Asia-Capital.

54 Coco Feng, "US Supreme Court Rules Against Chinese Vitamin-C Makers." Caixin, 15 June 2015. https://www.caixinglobal.com/2018-06-15/us-supreme-court-rules-against-chinese-vitamin-c-makers-101271916.html.

3 How can Europe respond?

Faced with Chinese structural barriers, market distortions, and trade and investment practices that harm EU economic interests, European policy responses can fall in three main categories: (1) accept the damage (if the cost to remedy it is higher); (2) negotiate to remove its source; (3) or try to offset it through promotional or defensive measures at home.

In an ideal world, the EU would be able to manage China-related concerns through negotiation and multilateral or bilateral cooperative means, in a reasonable timeframe. It would, for instance, turn to a reformed WTO rulebook developed with China, and see the PRC quickly acceding to existing WTO-associated plurilateral agreements such as the Government Procurement Agreement (GPA). New multilateral agreements on critical issues including competition policy and investment would be jointly developed, building on work in the G20 and OECD frameworks. Bilaterally, the EU's successful export of its own rules through competition and state aid dialogues with China would pay off, leading to Chinese convergence on both fronts. Most importantly, a strong EU-China investment agreement would not only lead to further market opening, but also to a broader levelling of the playing field, including through strong chapters on transparency and other disciplines for SOE behavior.

In reality, despite continued EU efforts across all of these dimensions, progress has been and is likely to remain limited. The recent re-positioning both of leading business organizations in Europe and of the EU Commission indicate that the damage caused by Chinese-induced distortions might now be too high to be ignored, and requires prompt responses.[55] There is great value already in further monitoring the scale of possible damages, and to evaluate and document the exact impact on EU stakeholders, especially as recent trends in Chinese policy-making and economic indicators do not point to improvement, but rather to potentially greater damage.

In this context, European member states and EU institutions now need to look for second-best policy tools that do not depend on Chinese cooperation. That mandate has been taken up by the EU Commission, who is reviewing gaps in EU law that prevent European policymakers from addressing the distortive effects of foreign state ownership and financing. We believe that a few options for responding to such distortions should be excluded from the outset: Shutting down European markets completely, or fully replicating China's statist and distortive policies, neither of which constitutes a realistic or acceptable solution. Europe also needs to avoid seeing all aspects of business relations with China through a national security lens. For example, security-related tools such as the new EU FDI screening framework should not be used to deal with all the consequences of China's state capitalism.

55 European Commission and HR/VP contribution to the European Council "EU-China – A Strategic Outlook"; BDI, "Partner and Systemic Competitor."

In the following stock-taking exercise, we contribute to the current debate and efforts by offering an assessment of relevant policy options for EU leaders. Some of these options are already discussed in Brussels and European capitals – and might well be implemented in the short term. We evaluate their potential impact and relative cost (financial, political, and diplomatic). Others are novel and came up in a series of interviews with practitioners and experts conducted between January and March 2019. We also distinguish areas for stepped up action based on existing rules (3.1) from opportunities to reform existing tools or create new instruments (3.2). We do not discuss "promotional" policies (increased R&D and education spending, or a smart industrial policy revival), which will have to be pursued in parallel as a response to the China challenge.

A prominent feature of the current debate in Brussels is that **some of the China-specific challenges driving the policy conversation seem to fall between traditional policy instruments.** The demand to address distortions associated with subsidized investments is illustrative. State financing can be a factor for scrutiny based on the new EU investment screening framework, but only on the grounds of a threat to security and public order. Financing conditions and subsidies can, according to practitioners, already be an element of the assessment in EU merger control, but only if they come with significant negative effects on competition. The anti-subsidy TDI can tackle subsidies systematically, but only for trade. Finally, EU state aid tools cover subsidized investments, but only for intra-EU activities.

In light of this complexity, in the following sections we identify diverse but interlinked policy spaces "beyond FDI security screening," including competition policy, specific trade-defense instruments (anti-subsidy ones in particular), state-aid and public procurement. Most of the options we discuss fall directly into the remit of EU policymaking, but WTO-related reform efforts also feature in our analysis. And some of the more innovative options are inspired by solutions found in other OECD countries.

To support ongoing European policy deliberations on these issues, provide important contextual information on each of these tools, and provide a basis for evaluating actions taken in the next couple of years, we provide an initial assessment of the effectiveness, feasibility and cost of these policy options. We also discuss potential for alignment with partners and implications for the EU-China relationship.

3.1 A more assertive and coordinated use of existing instruments

From a practitioner's perspective, ambitious reforms of existing tools or the creation of new instruments can seem distant or unfeasible. **One crucial course of action available to European stakeholders is therefore to lead parallel conversations about how existing practices and tools could simply be applied more effectively, systematically and forcefully to help mitigate the effect of China-induced distortions.** New priorities and practices could take various forms:

- **Increased EU-level action:** DG Comp, DG Trade, and other relevant EU institutions could become more proactive in signaling awareness and concerns to Chinese counterparts, including public statements and language on procedural fairness and due process in China and outside of the country. DG Comp for example could voice concerns publicly around Chinese megamergers, or around China's biased or political use of its competition regime. Going further, EU institutions could also step-up action, notably in launching investigations and filing EU and WTO (anti-subsidy) cases against Chinese non-market behaviors. DG Comp and DG Trade could both fill a few exemplary cases around Chinese SOEs or state-funding, to express concerns around Chinese distortions publicly. Finally, existing dialogues (for instance on competition and state aid policy etc.) could be made conditional on specific commitments by the Chinese side.

- **Increased intra-EU coordination:** The fragmentation of the EU's defensive tools and related institutions (and notably the strict split between DG Comp and DG Trade competences and activities) is likely to be a sub-optimal policy set-up when facing China-specific (and often systemic) challenges. The Union would benefit from increased communication, cooperation, and possibly even greater resource pooling across EU DGs and agencies. DG Comp and DG Trade could for example collaborate in "sector inquiries" and improve information sharing, also with member states and EU firms. Finally, EU institutions' more proactive behavior will need to be better aligned with the EU's research agenda and industrial policy or promotional measures.

- **Member states and industry support:** Clearer signaling and more pro-active case filing should be mirrored (and would need support) by member states and industry. Both should become more proactive in using some of the tools already at their disposal, such as certain provisions of EU's public procurement directive or anti-subsidy TDIs. This might require increased awareness-building and guidance from EU institutions on available instruments, as well as capacity building (for smaller member states) to support the enforcement of existing rules. European business "at home" (beyond the European Chamber of Commerce in China) could also take on even clearer and more coordinated public stances concerning industry-specific developments in China – as a way to lend support to EU institutions and member states' moves.

- **Doubling-down on transparency and compliance:** Both at the EU and member state level, existing regulatory compliance regimes (General Data Protection Regulation, anti-money-laundering, accounting, etc.) could be applied more comprehensively (if not expanded in their applicability) to seek greater transparency of Chinese corporates' financing and ownership structures. In particular, EU member states could launch **increased court actions** against Chinese companies' wrongful behaviors, as national courts can

force transparency on foreign players. Member state representatives would need to lead this initiative, as EU firms might prove unwilling to do so for fear of retaliation. Yet greater legal action should bear important consequences by shedding light on Chinese firm behaviors, forcing more transparency from Chinese actors, and more broadly, imposing a non-fiduciary but significant image cost on Chinese firms misbehaving on the EU market.

- **Upping remedies:** Finally, EU institutions and member states' adoption of remedies should be, where possible, intensified. In many cases so far, fines or punishment imposed are simply too limited to force behavioral change.

In short, shifting gears towards a more assertive, coordinated and pro-active response of EU stakeholders based on existing rules would be comparatively easy, support other measures in dealing with China-related distortions, and already bear a decisive effect in terms of signaling the EU's position. It could also have a positive effect in building necessary political support for a more united European policy stance on China, by proving that cases can be successfully filed and pursued using EU tools.

TABLE 1 **Policy options to redefine, revise or expand existing instruments**

Entry point	Short title	Description	Objective
Antitrust	Forward-looking monitoring and scrutinizing competitive risks from concentration	Options would range from an increased EU monitoring of global concentration patterns and their competitive effects, to alterations of EU rules to include more forward-looking elements in antitrust, or greater scrutiny of abusive practices by non-dominant players.	Efficient EU market, consumer protection
Merger control	Relaxing merger review conditions to allow for greater European market concentration	This could be done through: i) An upgrading or current rules to account for the closure of key target markets; ii) An extension of "efficiency gains" grounds to merger authorizations; iii) The promotion of longer-term perspectives when reviewing a merger; iv) Allowing for a merger's approval, with the possibility to subsequently force the combined company to make divestments if competitive problems emerge.	Competitiveness of EU firms
	Tolerating more expansive "legitimate interest" exceptions in merger control	Allow public authorities to broaden the scope for „legitimate interests" in merger reviews, for example to cover the protection of innovation capacity and critical value chains relevant for the long-term viability of the European industrial base.	Competitiveness of EU firms
	Promoting a more expansive single-economic-entity approach beyond formal aspects of state-control	Develop a more encompassing assessment of (Chinese) corporate networks and control in horizontally and vertically related markets, including beyond SOEs and formal aspects of state-holdings.	Efficient EU market, consumer protection
EU state aid rules	Expanding state aid exemptions	Expand (facilitate use) of exemptions to state aid rules, including block exemptions, ICPEI, and the use of the matching clause.	Competitiveness of EU firms
EU trade defense (anti-subsidy)	Strengthening and facilitating the application of EU TDIs for subsidies	Options here range from improving procedures, knowledge gathering and information sharing on Chinese subsidies to facilitate case filing by European industries and prove material injury, to more drastic solutions such as allowing DG Trade to initiate cases or shifting the burden of proof on to Chinese firms.	Global level playing field for trade and investment
WTO Agreement on Subsidies and Countervailing Measures (SCM)	Strengthening WTO subsidy notification requirements	Push China to publish a subsidy list, for example through a more extensive use of counter-notifications and penalties, or via the introduction of a general rebuttable presumption that non-notified or counter-notified subsidies be presumed subsidies (or even harmful subsidies).	Global level playing field for trade and investment
	Aligning forces on the "Public body" interpretation in WTO anti-subsidy rules	Forcefully support a broadening of the definition of „public body", to cover SOEs and hence account for subsidies disbursed by SOEs.	Global level playing field for trade and investment
	Broadening the scope of WTO subsidy coverage	Support a broadening of the scope of contestable subsidies under the WTO SCM to cover indirect subsidies and subsidies to upstream industries.	Global level playing field for trade and investment
Government/ Public Procurement	Promoting a more intensive use of EU's public procurement directives	Encourage member states to use Directive 2014/25/EU more intensively, including Art 84 and 85, and the MEAT principle.	Efficient EU market, consumer protection
All	Integrating EU's investigative resources	Pool together EU investigative resources for competition, trade and investment cases	Efficient EU market, consumer protection

Source: Rhodium Group and MERICS; own analysis and compilation.

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TABLE 2 **New instruments**

Adopting the EU International Procurement Instrument (IPI)	Push for a prompt negotiation and adoption of a revised IPI.
Introducing a "net benefit" test for foreign investment	Following the example of Canada, the EU and member states could expand existing investment approval schemes to include narrowly-defined economic criteria such as an investment's impact on innovation and productivity, Europe's industrial base and policies, or effect on global competitiveness.
Rethinking market power for digital giants and platforms	This option envisions greater emphasis on theories of harm associated with ecosystem-specific distortions rather than traditional market definition; access to data as an important criterion for measuring market power; and greater scrutiny of acquisitions of small startups by dominant platforms. It could, however, also require exemptions from European anti-trust regulations to facilitate cooperation of European businesses in the digital sector and for Industry 4.0 partnerships.
Extra-EU application of EU's state aid regime	This option envisions an "externalization" of EU's state-aid rules to scrutinize aid granted by non-EU governments to companies operating on the EU market. It could target practices such as Chinese subsidized takeovers of European companies, or operations of Chinese companies on EU soil.
Creating a pan-EU Competitive Neutrality instrument	Introduce a competitive neutrality tool based on the Australia model and implement for all (domestic and foreign) SOEs operating on member state territory. Complaints could be lodged with a dedicated agency, in cases where an SOE's behavior is found to distort "neutral" competition.
Creating a plurilateral agreement on government-driven competitive distortions	This option would entail negotiating an international agreement that promotes competitive neutrality principles and SOE discipline, but could also target specific forms of non-market-oriented behavior such as "government price driving", state aid, and procurement provisions.
Assertive unilateralism against illicit commercial practices	This option could entail the (re-)introduction of a more focused "Section 301"-like instrument to the EU's toolbox, also to create greater leverage for EU negotiators.

Source: Rhodium Group and MERICS; own analysis and compilation.

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3.2 Reforming existing tools and creating new instruments

Moving on to reforms of existing tools and/or the creation of new instruments, Table 1 and 2 summarize a series of policy options for European authorities in dealing with China-related market distortions. Our research has identified a wide range of theoretically applicable tools and possible reforms. The below tables present a selection of impactful options. Some are already widely discussed at the EU level and might be implemented in the short term. A few others we believe to be fruitful avenues for further action.

TABLE 3 **Assessment matrix**
red = very low, orange = low, yellow = moderate, green = high

	Impact	Feasibility/ avoidance of costs	Transatlantic alignment	China's tolerance/ acceptance
Addressing early competitive risks from concentration				
Relaxing merger review conditions				
Expanding legitimate interest exceptions				
Expansive "single entity" approach				
State aid exemptions				
Strengthen and facilitate TDI applic.				
WTO subsidies notification reqs.				
Public body interpretation				
WTO subsidy coverage				
IPI				
Net benefit test				
Rethinking market power for digital giants				
Pooling EU investigative resources				
Extra-EU enforcement of state-aid				
Pan-EU competitive neutrality instrument				
Plurilateral agreement on competitive distortions				
Assertive unilateralism				

Source: Rhodium Group and MERICS; own analysis and compilation. | BertelsmannStiftung

3.3 Assessment: Impact, feasibility and effect on partners

Ideally, given the systemic nature of Chinese distortions, policymakers would be able to deploy a similarly systemic response, i.e. involving the simultaneous deployment of several of the above policy options, across all types of policy areas, for maximum impact. In light of resource and attention constraints, policymakers will have to prioritize. In the following, we provide our assessment of the potential effectiveness of each of the above-listed instruments, their feasibility (financial, political and broader welfare cost), and their effect on EU-US and EU-China relations.

Impact

Some of the above options might be more impactful than others, or across a broader range of issues. **A tool's impact depends on how many of the China-induced distortions described above it can tackle.** Certain instruments are highly targeted at certain distortions. Using TDI for anti-subsidy cases, for example, will concentrate efforts exclusively on subsidies. So will WTO efforts to incentivize subsidy notifications, or to expand subsidies' and a "public body's" definition. Similarly, an extra-EU application of state-aid rules will only concern state-aid-induced distortions. And further exemptions to state-aid rules would help off-set the effect of subsidies received by Chinese firms.

As such, these instruments will display a high impact protecting EU firms against unfair prices advantage, and possibly against longer-term distortions and competitive imbalances in emerging industries, which happen to be highly subsidized in China. Yet these will have limited effect on constraining Chinese players' concentration or facilitating further market access for EU firms into China.

For their part, competition-based instruments will bear effects mostly in terms of concentration – and to some extent on price distortions – by allowing European players to realize further economies of scale through mergers, or by addressing harm from dominant or over concentrated Chinese actors.

In comparison, pooling together EU's investigative resources will influence most China-induced distortions – from subsidies and dumping practices to concentration and coordination – though only by increasing EU's case-filing abilities. A plurilateral agreement on government-driven competitive distortions could, similarly, seek to address a wide range of Chinese players' harmful behaviors. And a "net benefit test" for investment screening could aim to tackle most market distortions induced by Chinese investment into the EU – from excessive concentration, to subsidized investment, to longer-term competitive distortions.

Let us note finally that few instruments are targeted directly at allowing further market opening in China. This is because such opening would require cooperation on China's part, and hence, building leverage to encourage such cooperation. Only two instruments are of such nature: Rekindling an EU equivalent of US' "section 301", beginning with a more assertive interpretation and deployment of existing EU trade barriers regulations, which would help build up EU credibility for retaliation; and the adoption of an ambitious IPI, as the only available instrument integrating an element of reciprocity.

The share of China-induced distortions tackled by any one instrument is not the only factor determining a tool's effectiveness. **Another crucial factor is how much of China's activities (trade, investment, public procurement) or players (SOEs or private, different sectors) each tool will be able to cover.** For example, tools around merger control or investment screening

could only be applied to Chinese investment – and hence will have little utility protecting EU firms or consumers against trade-related harm. Conversely, TDIs and WTO tools will be mostly useful in tackling trade-related distortions, with little impact on subsidized or politically driven investments. Finally, public procurement tools, and especially the redefinition and further application of EU's public procurement directives, will only help tackle China's (limited) participation in Europe's public procurement market.

In terms of players, a redefinition of „public body" at the WTO would still focus mostly on SOE-driven distortions (i.e. subsidies provided by SOEs), as would an EU-wide Competitive Neutrality instrument – leaving out distortions induced by Chinese private firms. Similarly, a furthering of existing exemptions to state rules would have to be concentrated on specific sectors and could not be applied across the board.

To tackle as many Chinese distortions, activities and players as possible, an EU response would ideally be multi-pronged. **Simply put, given that China-induced distortions are systemic, a systemic response would also be needed.** In reality however, EU's political, financial and diplomatic resources for implementation are limited, and the EU will have to prioritize policy options carefully, comparing each instrument's potential impact to the cost of its implementation.

Ease/Difficulty of implementation

The cost of each policy option is tightly linked to the ease or difficulty of its implementation. Some of the above will be easy to promote, while others will require significant political, administrative or financial resources to deploy. Three factors in particular will come into play:

First is the legal complexity of each tool's creation, redefinition, or application. Instruments that already exist should be easy to deploy. These will merely require stakeholders to promote or facilitate a more systematic application. This is for example the case of EU's public procurement directives, which are already in use. The same is true for the recently reformed European TDIs, which now would merely need to be used more intensively by EU trade investigators and European companies. The single entity approach within EU's merger review process, and state-aid exemptions, too, exist in EU law or practice, and hence could be used more intensely should political will be strong enough to do so.

Other tools will however involve a heavier administrative or legislative burden. Adopting the IPI will mean creating a new tool (though part of that work has already been conducted in the previous two phases of negotiations). More importantly, above-mentioned reforms to the EU's merger review would for the most part require a significant overhaul of the current regime, potentially involving a treaty change. This would also be the case should a "net benefit test," assertive unilateral tools ("European Section 301"), or a legislation allowing for the extra-EU application of state-aid rules be introduced. The prompt creation of the FDI screening mechanism of course shows that significant legal changes are not out of reach with strong EU member states alignment and political will. Instrument creations, or significant overhauls, are heavier tasks.

WTO reforms would also involve significant administrative difficulties, yet these are more crucially hung up on the alignment of concerned stakeholders – which is the second factor underpinning each options' feasibility. **In fact, EU's ability to use certain existing tools more, redefine or widen them, or create news instruments, will largely depend on EU member states alignment for EU-based tools, and WTO**

members alignment for WTO-based tools. This need for alignment points to some foreseeable difficulties.

Certain reforms of course are already backed by some level of intra-EU alignment. For example, facilitating the use of TDIs is barely controversial, and many EU member states would likely welcome the extension of state aid exemptions for a limited number of emerging industries. However, others are much less consensual avenues for reform. Changes to the EU's competition regime for example are still widely opposed, both at the EU and member state levels. And though 26 out of 28 member states backed the EU investment screening framework, support might prove much thinner for a "net benefit test" approach to inward investment. In addition, while using the public procurement directive might raise limited opposition among member states, the adoption of the IPI has for years been impeded by the opposition of various member states. The tide seems to be turning slowly with an increased willingness (in Germany notably) to support the instrument, but an even broader alignment will be required to move forward. Finally, and at the more extreme end of the spectrum, tools regarded as protectionists in nature, such as an "EU section 301", will likely face strong opposition among member states. That is also the case of tools that could jeopardize the interests of certain EU countries, such as an EU "Competitive Neutrality" tool for EU members with a sizeable economic presence of SOEs.

One last barrier to implementation will be the financial cost attached to each option, which can be direct and indirect. Direct costs are the resources to be mobilized for each option's implementation. Encouraging member states to use certain existing tools more will entail outreach costs; expanding the use of TDIs, or adopting a "net benefit test" approach will increase investigative costs; pooling together EU investigative resources, though likely to lead to economies of scale in the longer run, will require set-up costs. Finally, a more pro-active response to China's industrial policy, in the form of further exemptions to EU's state-aid restrictions, will entail financial support costs.

Indirect costs will be harder to assess but should also be mentioned. These are linked to the way that some of the above instruments might tilt the balance from consumer protection to producer promotion in the EU. This would be the case of a reformed EU competition regime that allows for more concentration on the EU market, or anti-subsidy and public procurement instruments that would level the playing fields for EU firms, but increase import and/or procurement costs for EU consumers (individuals and tendering authorities) in the short-run. The rationale behind such moves is that short-term costs would be necessary to avoid a longer-term deterioration in EU's economic prospects, which rely in large part on the health and global competitiveness of European firms. Yet these indirect costs have to be understood and duly taken into account from the onset.

Finally, in devising an appropriate policy response, policy makers will have to strike a balance between the necessary speed of the response to prevent long-term damage to EU consumers and producers while making sure that policy measures don't overshoot and are adjusted to the actual problem.

Transatlantic and other partner alignment

Another key challenge for many of the policy options outlined above is that they will create the image of the EU becoming more protectionist and mercantilist and could lead to a spiral of defensive measures. This effect is likely to be particularly pronounced for an expansion of merger control, legitimate interest and state aid exemptions, and

if the EU was (forced) to choose a more assertive unilateralist approach.

Alignment with the United States, which is a crucial partner to drive forward any substantive reforms or create relevant international instruments, will in many cases not be easy to achieve. This is due to the fact that both have ongoing high-profile disputes in key areas related to the identified policy options: European competition policy decisions and the handling of digital service providers are already a significant irritant in EU-US relations, as might be issues like government procurement and the IPI.

On a more optimistic note, however, there is precedent and an increasing interest in expanding coordination on China-related trade and investment issues in the OECD framework, as well as the nascent US-Japan-EU core of a "like-minded club". These structures will be essential building blocks for any of the above policy options requiring coordinated action, such as the expansive single-economic-entity approach, different ways to create checks on subsidies, as well as the more ambitious option to create a "plurilateral agreement on government-induced competitive distortions". In more immediate and practical terms, information sharing and joint or parallel anti-cartel, TDI or WTO investigations could help bridge existing knowledge gaps which could bring about positive spillovers for "like-minded" China policy alignment. Flexible "like-minded" cooperation could facilitate issue-area specific learning, exchanges and coordination among G7 (and five-eyes) countries.

The EU and leading member states will also need to foster a broader alliance on critical issues of the WTO reform agenda. While many of the above proposed reforms are ones that are already being promoted by the EU and some of its partners, the difficulty will be in building WTO-wide consensus on the issues. The EU cannot afford to wait for Tokyo and Washington to take the lead and will need to be more inclusive in defining a functioning nucleus for rulemaking. At the same time, it seems unlikely that an equidistant positioning that criticizes the US for undermining the form (appellate body) while challenging China on substantive issues is a durable policy stance.

Gauging China's response

Finally, many of the policy options outlined above will lead to some rhetorical pushback from China – but reactions in Beijing could easily become more concrete and costly for the EU. Beijing's response will likely depend on Chinese leaders' assessment of the impact (harm) of any of the above measures. It will also likely be guided by principled grounds for opposition, i.e. whether any of the above allegedly "violates China's rights," affects its reputation, is China-specific, etc. Finally, the extent to which EU measures are aligned with partners is likely to intensify Beijing's criticism of Western players "ganging-up" against China – with some space for retaliation.

It is important to take such reaction into consideration for several reasons. First, Beijing's reaction will impact the effectiveness of an options' implementation, and especially so for options that depend in part at least on China (WTO reform, IPI, etc.). Second, Beijing's response can drive up the cost of policy implementation, for example by targeting EU companies operating in China. Third, the EU needs to preserve avenues for cooperation going forward, especially on issues such as climate change and international security.

China's response to the EU's reform of its Anti-Dumping regulation and investment screening frameworks are good indicators for what is to be expected. The former was challenged by China at the WTO (a case Beijing is about to lose) while the latter features prominently in Chinese rhetoric

about European protectionism, in turn helping China justify its own restrictive measures. It is likely, therefore that EU measures will face substantial initial resistance and will take time before they unfold their intended effect on actual Chinese practices.

In the context of the WTO, China will be most confident that it can prevent any change that affect its own interest. For EU-based policy measures, such as merger review and state aid exemptions, China might remain formally neutral. It is also unlikely that China would be directly engaging an emerging "like-minded club" on government-driven competitive distortions, but rather wait for effects to materialize. Beijing will also watch carefully developments related to competition policy in the digital era and will request rulemaking on eye-level. Harsher reactions are to be expected against reciprocity-inducing measures and defensive measures that prevent Chinese deal-making (legitimate interest exceptions, assertive unilateralism and the IPI).

BOX 2 SUMMARY OF INDIVIDUAL POLICY OPTIONS

Reforms and changes of existing tools

1. Forward-looking monitoring and scrutiny of competitive risks from concentration

Europe needs an effective monitoring system for when concentrated foreign control of an industry entails potential competitive (and national security) risks. An institution such as the EU Joint Research Center could develop a series of measure to determine which industries might be at risk. In these industries, (EU) government assistance may be tolerated if not warranted as a form of "anticartel insurance" to encourage a more competitive domestic supply base. A more ambitious reform attempt would seek to alter existing anti-cartel instruments. A lower market share threshold could enable anti-trust scrutiny of abusive practices by non-dominant players in specific cases based on economic analyses that evaluate future developments in relevant markets. The reform could also allow competition enforcers to tackle predation by non-dominant Chinese entities – which may be already dominant in their distorted home market – entering the EU market.

While stepping-up the EU's monitoring of competitive risks from concentration might be relatively uncontroversial and easy to achieve, lowering market share thresholds or introducing forward-looking elements in antitrust investigations will be more challenging, as it would require a change at least in secondary law and a major shift in competition policy practice. Implementing this tool could easily lead to over-enforcement (filing too many cases), which may generate unintended costs and could severely handicap small (non-dominant) European players. The tool would most likely only have a limited impact on Chinese practices.

2. Relaxing merger review conditions

Most recently discussed in the context of the Siemens-Alstom merger attempt and Franco-German plans for a European industrial policy,[56] the conditions for merger reviews could be adapted to allow for greater European market concentration in the face of global (Chinese) competition. This could take various forms. Current rules could be upgraded or re-interpreted to account for the closure of lead markets in which competitors are effectively building global empires; or to promote more dynamic perspectives (longer time frames) on global market developments when assessing a mergers' contribution to European long-term welfare (with a view to out-of-market efficiency gains) against the potential to induce short-term harmful concentration. The Commission could also be allowed to approve a merger, with the possibility to subsequently force the combined company to make divestments if competition problems emerge. Even more radically, some have even proposed introducing a right for member states to appeal DG Comp merger review decisions. In all cases, the logic is that authorizing more mergers can boost EU industrial competitiveness by creating "European champions" able to compete with large Chinese players.

Overall, there is some support among experts to the view that the Commission should give greater emphasis to potential competition in its merger appraisal. Most practitioners seem to believe, however, that a relaxation of merger review conditions to allow for greater intra-European market concentration would fundamentally undermine the Single Market, lead to a foreclosure of smaller competitors, increase prices, and constrain innovation. For post-merger mitigation, critics point to the resulting legal uncertainties for

56 "EU's rail merger veto ignites spat over competition rules," France 24, 6 February 2019, https://www.france24.com/en/20190206-eus-rail-merger-veto-ignites-spat-over-competition-rules; Which Competition And Industrial Policies For The New Eu Commission After Siemens/Alstom? Concurrences, n°2, 2019, https://www.concurrences.com/en/review/issues/no-2-2019/on-topic/which-competition-and-industrial-policies-for-the-new-eu-commission-after-en.

companies. There is little support to the view that protecting firm competitiveness (for instance infant firms) should be a consideration guiding competition enforcement, because rivalry tends to improve productivity and because of the risk of capture. What's more, larger European players would not necessarily be able to compete with Chinese ones, as the latter are subsidized and sheltered from competition on their home market.

Technically, substantially changing the EUMR and current merger guidelines (to enable Franco-German proposals to be adopted) requires unanimous decision of all member states, which would be very difficult to secure. Member states do not seem to be aligned so far on the issue, with dissenting voices cautioning against the use of competition provisions for (German and French) industrial policy purposes. And many European business associations are likely to be opposed to the reform as well. To circumvent the role of unanimity, the European Commission could amend its guidelines to give more weight to "the development of technical and economic progress" (i.e. pursuit of the public interest) vis-à-vis possible obstacles to competition in future decisions.

3. Tolerating more expansive "legitimate interest" exceptions in merger control

The EU Merger Regulation stipulates that member states may take appropriate measures (reject or mitigate mergers) to protect "legitimate interests", defined non-exhaustively as involving public security, plurality of the media and prudential rules for financial services. This option would envision a broadening of this category, for example to cover the protection of innovation capacity and critical value chains relevant for the long-term viability of the European industrial base. The Commission would retain sole jurisdiction to investigate whether a concentration gives rise to competition concerns, while the scope for member states would be broadened to carry out parallel investigations focusing on legitimate interest. This would allow member states to assess the potential effect of deals not only on their national security, but also on elements of their economic security and competitiveness in the medium and long-term, hence offsetting some distortive Chinese practices, such as (often subsidized) acquisitions in strategic European industries.

In principle, implementation could be relatively easy, as member states claiming new public interests would simply have to communicate those to the Commission. In practice, however, legitimate interest exceptions have only very rarely been successfully invoked by member states, as they require recognition as compatible with the general principles of EU law before the Member State can take any measures. The EU Commission has so far taken a strict approach to legitimate interest, to avoid any disguised protectionism.[57] Finally, the main problem with expanding the scope of legitimate interests is that it would often conflate competition, competitiveness and security considerations, leading to a further politicization of merger control.

4. Promoting a more expansive single-economic-entity approach beyond formal aspects of state-control

Over the past years, the Commission has already considered in several merger control cases the possibility that ultimate control of Chinese SOEs lies with central authorities (SASAC) and that they lack independent decision power. So far DG Comp has concluded, however, that either horizontal or vertical linkages were not relevant (CNRC/Pirelli, Weichai/Kion)[58] or that while combined market share or turnover thresholds were reached for the EU to take action, the transactions did not raise immediate

57 Competition Policy International, "CPI Antitrust Chronicle," Oct 2014, https://www.competitionpolicyinternational.com/assets/Uploads/BrandenburgerJonesOCT-141.pdf.

58 European Commission, "Case No M.7643 – CNRC/PIRELLI: REGULATION (EC) No 139/2004 Merger Procedure," 2015, http://ec.europa.eu/competition/mergers/cases/decisions/m7643_437_2.pdf; European Commission, "Case M.8190 – WEICHAI/KION: REGULATION (EC) No 139/2004 Merger Procedure," 2017, http://ec.europa.eu/competition/mergers/cases/decisions/m8190_150_3.pdf.

competition issues (CGN).[59] Going forward, a more encompassing assessment of (Chinese) corporate networks and control in horizontally and vertically related markets (including, for instance, through "national teams", industrial policy plans, or financing by state guidance funds, as well as beyond formal aspects of state-holding) could be warranted.

At a minimum, more ambitious information requests could help improve the transparency around Chinese corporate linkages and control. Such expanded interpretation would also help tackle (and prevent) formal and informal concentration among Chinese players in various industries. An expansion beyond formal state-control is also possible, though it could create blurred lines in investigations that will be hard to implement in a consistent manner. It is thus unclear whether a by-default expansive interpretation of corporate linkages would be desirable in most circumstances. In any case it would require increased resources for investigative purposes.

5. Expanding state aid exemptions

State aid rules limit member states' ability to support European companies to a few exceptions. An option would be to use existing exceptions more extensively, or to expand such exceptions to more cases or industries. This could take the shape of further R&D support for Important Projects of Common European Interest (IPCEI, only two cases have been allowed so far). It could also take the shape of further "block exemptions" (specific categories of state aid compatible with the Treaty). Finally, it could take the shape of a further use of the "matching clause", which allows R&D support when it offsets that received by non-EU competitors (but has never been used).

Such exemptions could help address (if only partially) unfair competition stemming from widely state-supported Chinese players and strengthen EU industrial competitiveness without too much of an effect on competition in the Single Market. Another key advantage of this option is the flexibility of EU state aid rules, which would make it relatively easy to implement. However, critics fear that excessive extension of exemptions might open the way to industrial interventionism. Relatedly, some point to the high financial cost of trying to match Chinese subsidies. What's more, financial wastage may arise from supporting pan-European projects, as support alone does not guarantee a successful industrial policy.

6. Strengthening and facilitating the application of EU TDIs for subsidies

Linked to the anti-subsidy regime under the EU's trade defense instruments, this option would seek to improve procedures, knowledge gathering and information sharing on Chinese subsidies to facilitate case filing by European industries and prove material injury. While it will be difficult to fully mitigate the lack of transparency in China's subsidy notification system, Commission officials are confident that after recent TDI reforms DG Trade's investigative and enforcement powers could be leveraged more proactively if industry filed more and with appropriate information provided. The new track-record of parallel investigations (anti-dumping and anti-subsidies) as well as the fact that the Commission even countervailed a Chinese government fund's acquisition financing in a recent TDI case (Pirelli) certainly indicate the potential of a more comprehensive approach. It also highlights the challenges in adapting anti-dumping instruments to new circumstances (here: circumvention through localization). Though the impact of this policy option will be constrained by the opaqueness and increasing sophistication of China's subsidy system (state guidance funds etc.), implementation costs would also be limited to deploying more investigative resources.

59 European Commission, "Case M.7850 – EDF/CGN/NNB GROUP OF COMPANIES," 2016, http://ec.europa.eu/competition/mergers/cases/decisions/m7850_429_3.pdf.

Note that beyond anti-subsidy TDI filing facilitation, more groundbreaking options for TDI reform could include developing service-specific TDIs, or even shifting the burden of proof around subsidization to (Chinese) state-owned or state-backed entities (in this scenario, preventive measures could be taken until such firms prove an absence of subsidization, or an absence of harm for European competitors). More drastic reform steps would also allow DG Trade to initiate anti-subsidy cases in EU firms' stead, as is already possible for anti-dumping or competition cases.

7. Strengthening WTO subsidy notification requirements

The WTO Agreement on Subsidies and Countervailing measures (SCM) does not provide adequate remedy, among others, against Chinese subsidization. Reasons for China's lack of transparency and notification compliance are multifold and make it hard for foreign authorities to prove and contest Chinese subsidies (proof of material injury is needed to start an investigation). Several measures could be taken to increase transparency and notification compliance.[60] This includes more extensive use of counter-notifications, and penalties ("administrative measures") for continued non-compliance including increased budgetary contributions but also restrictions to representation and speaking rights. The SCM could also operate with a general rebuttable presumption that if a subsidy is not notified or is counter-notified, it would be presumed to be a subsidy or even be presumed to be a harmful subsidy. Other less intrusive options revolve around a strengthening of the Trade Policy Review Mechanism and the WTO taking a leadership role in facilitating trad-related open data standards. Pushing China to increase transparency around subsidies would go a long way in facilitating case filing for European competitors, as well as publicizing China's distortive state support in a way that might encourage its reduction.

As with other WTO reform proposals, implementation of the steps above will depend on Beijing's (and other members') cooperation to significantly amend existing WTO practice if not the SCM agreement. Even if WTO requirements would change, the external commitment to achieve full transparency will continue to clash with China's ambitious industrial policy goals and is hardly imaginable without systemic reform in its legal system.

8. Aligning forces on the "Public body" interpretation in WTO anti-subsidy rules

WTO's anti-subsidy instruments have limited effectiveness in dealing with China's economic model because members can only impose countervailing duties orders (CVDs) against trade subsidies granted by a government or "any public body". In a far-reaching act of interpretation, public bodies have been defined by the WTO Appellate Body as organizations possessing, exercising or explicitly vested with "government authority" and performing "governmental functions". Leading WTO members, including the US, contest this treaty interpretation in favor of a more straightforward definition that includes all entities controlled by the government. The EU and member states could more forcefully support this position in line with the EU's shift in handling Chinese SOEs as single entities in merger cases. This would allow to address more comprehensively current subsidization practices in China.

Reaching a WTO agreement on this will continue to be highly challenging, not least because the current stand-off at the WTO on the Appellate body (the US blocking nomination of judges) is linked to this issue. It is also questionable that WTO members could agree on a clarification or interpretation guidelines of relevant WTO rules, or otherwise implicitly back-track Appellate body conclusions in previous reports. An

60 Wolfe, Robert. 2018. Is World Trade Organization Information Good Enough? How a Systematic Reflection by Members on Transparency Could Promote Institutional Learning. Bertelsmann GED Paper. https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/MT_Is_World_Trade_Organization_Information_Good_Enough.pdf.

explicit redefinition of "public body" would likely run against China (or other members') opposition.

9. Broadening the scope of WTO subsidy coverage

This option envisions broadening the scope of contestable subsidies under the WTO SCM to cover indirect subsidies and subsidies to upstream industries (which benefit downstream SOEs in exports). Currently these types of subsidies are much less contestable under WTO rules and escape CVD investigations. Reform proposals have focused on an expansion of the WTO existing list of prohibited subsidies to include grants, unlimited guarantees of financial obligations, subsidies to insolvent companies or failing companies, exclusive rights, regulatory advantages or preferential pricing for inputs. Targeted remedies against subsidies aimed at maintaining or expanding capacity beyond commercial considerations could be allowed. Another option would involve creating a rebuttable presumption of serious prejudice (adverse effects such as export displacement).

Indirect and upstream subsidies fuel sectoral distortions and overcapacities, which China then exports overseas. The advantage of this option is that it addresses such market distortions more systemically. However, as the WTO defines subsidies as "financial contribution" and only explicitly bans export and import substitution aid, this reform would require major regulatory changes. Given the current impasse in WTO reform, and likely opposition from China (and other members), this option might be hard to implement.

10. Using the EU public procurement directive more intensively

In terms of public procurement rules, the EU already possesses powerful instruments to level the playing field for European firms. Yet many are either not known well, or not deployed systematically. This is the case of Art 85 of Directive 2014/25,[61] which stipulates that tenders may be rejected when the proportion of products originating from third countries exceeds 50 % of the total value. This is also the case of the so-called MEAT principle, which allows national authorities to take environmental, qualitative and social factors into consideration, rather than just price, in their public procurement decisions. Finally, Art. 84 of the Directive encourages member states to reject (or at least review) "abnormally low tenders." Criteria for these three tools could be defined further and be better communicated to member states to encourage their application.

This option has the advantage of being very easy to implement. It only necessitates more consistent enforcement, without requiring regulatory upgrades. Encouraging implementation would also require a more proactive role on the part of the Commission (educating stakeholders, persuading national authorities), but costs would be limited. It would finally be effective in making sure EU firms are facing fair competition on the EU's procurement markets not only from a purely cost-based perspective. The application of this option may however generate additional administrative burdens, for member states in their reviews of tenders, and for the Commission in its outreach efforts to make sure public procurement rules are fully understood and applied.

61 Official Journal of the European Union, "Directive 2014/25/EU of the European Parliament and of the Council," 26th February 2014, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0025&from=EN

11. Pooling EU investigative resources for competition, trade and investment cases

So far, different EU instruments (merger control, trade instruments, investment screening) are being deployed by different institutions at the EU and member states' level. This means that investigative capacities linked to each of these, notably as relates to China-specific cases, are still somewhat fragmented, with limited opportunities for information and skills exchange. One option to bridge this gap would be to pool together these resources in a more systematic manner. One could, however, also imagine creating a single EU investigator for competition, trade and investment instruments.

This would have various advantages. It would create economies of scale, and hence reduce costs for EU and member states attached to case filing and investigations. It would allow for greater information exchange across instruments and cases – hence increasing investigative efficiency, and making sure information gathered in past or different cases is not lost to investigators. Finally, it would allow for a degree of specialization and expertise on China-specific cases aimed to deal with China-induced competitive, trade or investment distortions. The main barrier to this option is that it would involve creating bridges between (so far) separate institutions and competencies, across DGs notably, both also possibly across member states. This could prove difficult, especially if it involves shifting existing power balances. There might also be important barriers to sharing sensitive and detailed case-specific information across EU institutions, as this could raise issues around the protection of company secrets. Finally, a unified investigator might centralize too much decision power.

New Instruments and approaches

12. Adopting a strong EU International Procurement Instrument (IPI)

First proposed by the EU Commission in 2012 and amended in 2016,[62] the IPI would enable the EU to restrict access to its procurement market in cases where a substantial lack of reciprocity is found in a public investigation and when procurement products are not covered by existing international commitments by the EU. Hence, if successfully leveraged, the IPI could help in addressing European companies' difficulties in accessing China's trillion Euro but highly protected government procurement market. Indirectly, the tool may also prevent subsidized Chinese companies from presenting below-market offers in EU tenders.

Despite member states converging on the general idea of the IPI, the main challenge remains a lack of Europe-wide consensus on the specifics of the issue, with some member states and industry organizations demanding amendments to the current version of the text. These include, in particular, avoiding implementation costs for contracting authorities in member states, additional burdens for companies, and legal uncertainties for EU companies and awarding authorities. More generally, the concept of reciprocity remains alien to EU competition policy and easily triggers fears of protectionism.

62 See the 2012 and 2016 proposals: European Commission, "Proposal for a regulation of the European Parliament and of the Council," 29th January 2016,http://trade.ec.europa.eu/doclib/docs/2016/january/tradoc_154187.pdf; European Commission, "Proposal for a regulation of the European Parliament and of the Council," 21st March 2012, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012PC0124&from=EN.

13. Introducing a targeted "net benefit" test for foreign investment

Member states' investment screening mechanisms and the EU's new screening framework focus exclusively on threats to security and public order as screening triggers. Merger control at the EU level is limited to transactions where certain turnover thresholds are met and focuses exclusively on whether a "concentration" would "significantly impede effective competition." If desired, in theory, each of these anchor points (or both) could be used to introduce other economic factors into screening considerations.

Following the example of Canada,[63] the EU and member states could expand existing investment approval schemes to include what should be narrowly-defined economic criteria such as an investment's impact on innovation and productivity, Europe's industrial base and policies, of the effect on global competitiveness. In a very narrow fashion this test could also specifically be targeted at subsidization of investments and its market distorting effects. A net benefit test would be country-neutral but would potentially be effective in addressing long term, detrimental effects of unfair Chinese investment competition on European players.

This option comes with various severe drawbacks. Purely economic factors are basically excluded from possible screening factors based on the current EU treaties which makes this option hard to implement. In terms of practicalities, it is also unclear which authorities should be vested with such potentially wide-ranging powers. A shared responsibility of member states and the Commission might seem feasible. In any case, there would be serious costs to such an expansion as more transactions would likely be reviewed. While the example of Canada shows that a prudent and non-politicized application of such an instrument is feasible, concerns about political interferences and the creation of new barriers to inward investment could erode the image of the EU as an open investment destination.

63 Canada Law/Loi Justice, "Investment Canada Act | Loi sur Investissement Canada," 6th June 2019, https://laws-lois.justice.gc.ca/PDF/I-21.8.pdf.

14. Rethinking market power for digital giants and platforms

This idea is already present in emerging debates on competition policy in the digital age. This option envisions greater emphasis on theories of harm associated with ecosystem-specific distortions rather than traditional market definition; access to data as an important criterion for measuring market power; and greater scrutiny of acquisitions of small startups by dominant platforms. DG Comp and major member states' authorities are currently assessing new challenges of digitization, particularly competition distortions caused by digital platforms and the related need to protect consumers data, in addition to their freedom of choice between platforms.[64] Policy options also include a relaxation of anti-trust rules to allow for closer cooperation of European business in the digital sector or industry 4.0 partnerships.

Putting these proposals to practice will be difficult, however. Specific challenges seem to be the intensity of regulatory changes required and the technical difficulties associated with a redefinition of markets and market power to consider network effects, gatekeeping roles, and conglomerate effects. But if implemented, these new principles and practices are likely to have a large impact on interactions with Chinese digital giants and platforms, with possible gains for consumer welfare, a more level playing field for European companies – which are much smaller in size compared to their Chinese acquirers and/or competitors.

64 Jacques Crémer; Yves-Alexandre de Montjoye; Heike Schweitzer, Competition policy for the digital era, Luxembourg: Publication Office of the European Union, 2019 http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf.

15. Extra-EU enforcement of state aid rules

So far, EU state aid rules only apply to EU member states' support to companies on the European market. This tool envisions an "externalization" of such rules to scrutinize aid granted by non-EU governments to companies operating on the EU market. It could thus target practices such as Chinese subsidized takeovers of European companies, or operations of Chinese companies on EU soil.

In theory, this instrument is highly appealing in that it would help re-level the playing field for European companies on the EU market in a significant way (though it would not correct distortions on third markets). Implementation could be very challenging, however. It would require major changes to EU treaties, and hence consensus among member states. It would also require setting up an implementing mechanism to be applied to non-EU states. Given its extra-territorial nature, the tool would risk alienating partners, absent a parallel multilateral agreement on the matter. Finally, identifying Chinese subsidies remains extremely difficult, making case filing a challenge.

16. Creating a pan-EU Competitive Neutrality instrument

This option would entail introducing in the EU a competitive neutrality (CN) tool on the model of Australia's. The Australia CN instrument aims to offset competitive advantages resulting from government ownership, and enable a comparable basis for competition between a government business's activities and those of its competitors. While Australia's Competitive Neutrality (CN) tool only applies to Australian SOEs,[65] it is at least conceivable that the EU's version could apply to all state-owned businesses operating on its territory while replicate most of the other Australian CN features. Complaints could be lodged with a dedicated agency, in cases where an SOE's behavior is found to distort "neutral" competition. If such a complaint is justified, the agency could require the state-owned enterprise in question to make changes offsetting its competitive advantages. This would notably involve payments to reestablish tax neutrality, debt neutrality, regulatory neutrality, and a "neutral" rate of return.

This option would empower the EU to act unilaterally, instead of having to wait for its bilateral dialogues, or WTO reform efforts, to bear fruits. Clear drawbacks include, however, pushback from EU member states and OECD or other economies with a relevant share of state-ownership in their economy (Norway being an example). An expansive CN instrument will also be difficult to implement and could be used as a purely protectionist tool to keep foreign state-owned players out of the market.

17. Plurilateral Agreement on Government-driven Competitive Distortions

This option would entail negotiating an international agreement that promotes competitive neutrality principles and SOE disciplines but could also target specific forms of less market-oriented behavior such as "government price driving", state aid and procurement provisions. There are several paths towards the creation of such rules: Typically, ambitious FTAs (EU-US trade agreement or both joining an enhanced TPP) would be the way forward. A much less directly effective option could see more organized and coordinated action at the WTO around a re-vitalized market-economy definition and WTO Working Group on the Interaction between Trade and Competition Policy (WGTCP).[66] In the current environment, a narrower "like-minded fair competition club" that draws on OECD rules and focuses on selected agreeable (minimal) standards among leading market economies could be a more effective device to close existing loopholes in the multilateral system.

65 The Australian Government, "The Department of Finance Archive," Department of Finance, 2004/01 http://www.finance.gov.au/publications/finance-circulars/2004/01.html.

66 WTO, "Interaction between trade and Competition Policy," World Trade Organization, https://www.wto.org/english/tratop_e/comp_e/comp_e.htm.

In an advanced version of such an agreement, companies (including Chinese ones) found to misbehave would be fined or banned based on domestic rules and enforcement. A less ambitious approach would involve more institutionalized coordination of like-minded partners in joint or parallel investigations. In addition to its possible direct effects, such measures would strongly increase leverage on China to implement further domestic reforms and/or to accept further WTO reforms.

The most obvious challenges for such an agreement include questions regarding WTO compliance and difficulties to negotiate such rules even among "like-minded" partners as interests as well as existing competition policy practice, procurement rules and SOE treatment diverge. The perennial question also remains whether pursuing what should (again) be a multilateral agenda in a plurilateral fashion undermines and threatens the WTO. In any case, a duplication of rules with overlapping FTAs would need to be avoided.

18. Assertive unilateralism in battling illicit commercial practices

The EU can't choose its future independently and might have to adapt to a much grimmer global trade and investment environment in which multilateral regimes collapse in atrophy and major trading partners including China double-down on unfair competition. To prepare for such a scenario, the EU needs to debate how it could re-introduce more forceful European instruments to deal with illicit commercial practices. The EU has had its own experiences with such an approach, both on the receiving end (US "Section 232/301") and as an actor (EC Regulation 2641/84). A "European Section 301" instrument and selective reciprocity could be defensible as an interim response also against Chinese market distortions, particularly if sector-specific bilateral negotiations were intended and used to formulate non-discriminatory market-opening arrangements.

The downsides of such an approach are well-known but hard-nosed realism might need to prevail against sentimental attachment to a failing liberal multilateral trading system. In any case, WTO compliance should be a primary but not an ideological concern. Other risks include trade- and investment diversion, a poisonous atmosphere to progress on WTO reform and costly retaliatory measures if not all-out trade wars.

4 Conclusions and recommendations

This report takes stock of the defensive instruments available to EU member states and institutions to address distortions stemming from China's economic model that have the potential to harm EU consumers and producers. Given its narrow focus on second-best and defensive options, it leaves out two important strands of action:

First, defensive actions need to be complemented by ambitious "promotional" measures to level the playing field with China, ensuring continued European competitiveness. Measures include further investment in key European assets – education, research, innovative capacity – and a smart industrial policy that builds on and translates Europe's liberal foundations into a new global context.

Second, few of the above instruments target distortions that affect competition in third markets. Some multilateral tools mentioned above could play a limited role: better management of subsidies at the WTO level, or forming a "club of like-minded members" that would cover these markets. Yet more specific responses might also be needed to address third-market distortions: a more proactive engagement with the OECD's export credit scheme, DAC and Paris Club forums, among others.

Neither of these two areas are covered by this report. But both demand further study as ways to preserve European interests and competitiveness, especially in light of Chinese practices.

Finally, this is a report about a moving target. There is a dynamic and diverse European debate about the EU-China economic relationship, and changes in approach are already apparent both at the level of the Commission and member states. Meanwhile, the US-China trade dispute has increased the uncertainty about structural reforms and prospects for the EU's negotiations with China. Lastly, EU institutions are likely to soon propose specific measures to tackle action points 6 to 10 of the March 12 "Strategic Outlook." The policy choices outlined above could help EU stakeholders evaluate the focus, the level of ambition, and the potential impact of any new proposals.

In this section, we develop two sets of recommendations. First, we propose a minimal agenda for time- and resource-constrained policymakers. It includes easy yet necessary changes in the short run. Second, we out outline what a more ambitious, longer-term reform roadmap could look like, should Brussels and EU capitals back a consolidated strategic agenda for a European China policy.

A minimal agenda for action

Despite the recent level of China activism in Brussels, we don't expect a "big bang" policy shift given constraints on an EU Commission in transition and the contested nature of some of the proposals currently being discussed. Two particularly contentious policy proposals – relaxing

merger control conditions[67] and introducing the IPI for reciprocity in government procurement – have sparked heated internal debate and face significant opposition that might hinder them from fully materializing any time soon.

However, these two key policy items do call for a longer time horizon in assessing global competition and possible spillovers. The railway industry is a case in point. The only high-speed rail that Chinese rail giant CRRC has concluded to date contract in the EU is a EUR 20 million deal with the Czech Republic for the provision of three high-speed trains. In conventional and urban rail, the company also scored very few wins: 71 engineering carriages for London Underground, and twenty hybrid locomotives for Germany operator Deutsche Bahn. But given the level of government support, the strategic market closure at home, and the capacities and determination of the Chinese state-owned behemoth, there is no doubt that European railway companies and suppliers will face stiff – and likely unfair – competition in the medium-term.

This suggests that the EU should endorse a minimal agenda – one that is politically feasible and lays the ground for more ambitious steps. Such an agenda would include the following elements:

First, the EU needs more assertive and integrated practices, aligned with European industrial policy priorities. As outlined in section 3.1 of this report, this would include the EU more actively voicing concerns about Chinese practices, taking more and higher profile measures against Chinese infringements, increasing intra-EU coordination about such cases, mobilizing business and member states further, and doubling down on compliance cases.

67 Bundesministerium für Wirtschaft und Energie, Ministerstwo Przedsiębiorczości i Technologii & Ministère de l'économie et des finances, „Modernising EU Competition Policy", https://www.bmwi.de/Redaktion/DE/Downloads/M-O/modernising-eu-competition-policy.pdf?__blob=publicationFile&v=4.

Second, the EU needs to make more intensive use of existing instruments, including the public procurement directives and the newly reformed anti-subsidies trade defense instrument. Both of these tools can tackle distortions created by subsidized or state-backed trade and public procurement activities on the part of Chinese players. They could easily be used more intensively at minimal extra cost.

Third, the EU needs to recognize the "China factor" in developing new rules, such as a competition regime adapted to the digital economy. Some of the EU's current debates are not directly about China, but rather about structural changes in the global economy. But as these debates could lead to important rules changes, it would be helpful if they also addressed China-related concerns.

Finally, the EU needs to develop better institutional mechanisms across all DGs – to drive a forward-looking investigation of competitive risks, and more proactive enforcement. EU stakeholders need to systematically gather evidence on Chinese practices and on harm done to European producers and consumers. This would make it easier to improve and intensify the use of existing tools, especially anti-subsidy trade instruments and public procurement directives.

Towards a strategic approach

We are convinced, however, that this minimal agenda is not enough to promote continued and healthy competition in the EU's internal market, to level the playing field for European firms, and to preserve European competitiveness vis-à-vis China. It has to be complemented by a more systemic and holistic approach to tackling "the China problem," and to addressing the effects of a non-market player moving to the core of the global economy. This holistic approach should hence focus on all kinds of "government-induced

market distortions" that effect EU firms and consumers. It would require pan-EU mobilization, as well as a coordinated international agenda that goes beyond WTO reforms. It would seek alignment of concepts and policies as well as effective rulemaking to tackle government-related competitive distortions in plurilateral arrangements agreed by like-minded countries.

These efforts would require a fundamental change in perspective, mindsets and underlying concepts. In short, **the rules that apply should be different if the state is sitting at the table and impacting commercial activities in a non-market-driven manner and in areas that are not recognized by the OECD as relevant for public services or other legitimate interests.** In consequence, state ownership or influence should be taken into consideration systematically, across all policy areas, and not just on a case by case basis.

Focusing the policy agenda on "government-induced market distortions" demands a rethinking of theories of harm around foreign government action and market power. Practically, this could involve moving towards an approach that presumes non-market, government-driven behavior to be harmful. For example, in anti-subsidy trade cases this could mean shifting the burden of proof of appropriate market behavior to state-influenced market actors. In competition policy, this could mean considering a company that does not seek to maximize its profit - a Chinese SOE, for example -as having market power because it is not effectively constrained by competition. Finally, this could mean a modernization of merger-control guidelines to account for state control and subsidies when calculating turnover.

To prepare the ground for such a paradigm shift in Europe, there are a series of smaller but necessary steps that the EU and member states could take in the next 12 months:

(1) **Identifying and monitoring the issues at stake:** There is an urgent need to gather better information about the nature of Chinese market distortions, their systemic features, and their impact on Europe and other regions. The 2016 Staff Working Document on distortions in the Chinese economy already gathered significant case-based evidence,[68] but more will be necessary. It will be crucial to quantify and monitor the problems and harmful effects identified in order to adjust responses, understand how many resources can be mobilized, and build a common European narrative. The EU Commission should work closely with member states, business associations, and research institutions to close this information gap. Building on action point 8 of the March 2019 Strategic Outlook, it also remains an urgent task to identify weaknesses in the EU legal framework in the face of changes in the global competitive environment and market distortions by key trading and investment partners.

(2) **Building EU political support around these issues:** Similar to efforts that have led to the adoption of the General Data Protection Regulation (GDPR), the EU needs a multidisciplinary and multi-level debate about market distortions induced by governments like China's. This debate would need to involve DGs and member states, and also in-house and external research institutions like the JRC and EPSC. In parallel, EU authorities would have to communicate their aims to raise public awareness and ensure political alignment.

68 EU Commission, "Commission Staff Working Document On Significant Distortions In The Economy Of The People's Republic Of China For The Purposes Of Trade Defence Investigations", SWD(2017) 483 final/2, http://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf.

(3) **Creating more institutionalized coordination mechanisms at EU-level:** Both (1) and (2) would benefit from a "EU-China Economic Futures Task Force" that would enable research and coordination efforts, and encourage exchanges between DGs, member states, business associations, and other relevant stakeholders. Bundling relevant competencies – competition, trade, industrial policy – in the portfolio of a Vice-President of the Commission would greatly help to align forces on this issue.

(4) **Showing action, establishing linkages, intensifying remedies:** EU and member states' authorities should push for high-profile investigations into Chinese corporate actions shaped by government-induced market distortions. Filing a series of high-profile cases would display commitment. It would also show all actors that at least some cases are winnable, hence building confidence and broader consensus. An EU "enforcement task force" would be responsible for initiating and building cases. China-related systemic challenges require systemic responses. High-profile cases should be launched across all policy areas outlined above – competition, trade defense, investment, public procurement, and broader compliance. While distortions would be tackled using a variety of instruments, linkages between distortive practices would be established and made public. If cases were brought, remedies would have to be flexible and forceful to change Chinese entities' behavior.

(5) **Working with partners:** Any action taken by the EU will benefit from "strength in numbers",[69] i.e., many like-minded partners coming together to devise international arrangements and rules that will help to manage systemic competition in the decades ahead. Given its mandate and expertise – for instance on the issue of competitive neutrality – the OECD would be a key forum to drive rational debates and analysis forward.

There is no doubt that Europe will face tough choices if the structural divergence of Chinese (economic) policymaking continues. China policy today touches on the very foundations of what the European project is and can be about. For the moment, EU leaders are standing behind the latest EU-China joint statement and its related aim to once again test whether bilateral talks, and promoting "first-best solutions," are still possible. If the deadlines agreed at the EU-China Summit in April are not met, the EU will have to shift gears and pursue a more assertive agenda, including the coordinated measures outlined in this report.

69 Wendy Cutler, "Strength in numbers: Collaborative Approaches to Addressing Concerns with China's State-Led Economic Model", Asia Society Policy Institute Issue Paper, April 2019, https://asiasociety.org/sites/default/files/2019-04/Strength%20in%20Numbers.pdf.

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