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The EU's unsustainable China strategy

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Summary

- EU–China relations have become increasingly strained in recent years. For the most part, the EU's approach to China has been driven by the economic interests of a small number of member states, but relations are becoming more complicated. Internal and external political tensions make doing business in and with China even more difficult, while the country's emergence as an economic competitor has reinforced the EU's insecurities about its own future economic position in the world.

- China's heated rivalry with the US has also become an issue of contention in the transatlantic relationship, despite the EU having similar and growing frustrations over China. The Biden administration is keen to work with allies in dealing with China and the EU has so far suggested a limited willingness to do so.

- Beyond developing a toolkit of small, largely defensive measures, the EU's approach to the economic challenge from China, as well as to broader geopolitical and geo-economic issues, has been to pursue 'strategic autonomy'. It aims to be a neutral, but not equidistant, third pillar in a world order dominated by China and the US.

- This is a risky and largely unsustainable strategy. If not followed through with enough conviction, it could result in continued soft triangulation and less effective attempts to profit economically. The EU will remain vulnerable to economic and political pressure from both the US and China, as demonstrated in early 2021 when China imposed sanctions on several European actors and the US threatened to impose sanctions and tariffs on several member states.

- The investment agreement that the EU concluded with China at the end of 2020 highlights many of the difficulties in current European China policy. Attempts to reap the benefits of deeper economic engagement with China led to political tensions with the US. Subsequent mutual imposition of sanctions between the EU and China delayed or halted ratification of the agreement and highlighted the difficulty of separating the economic and political spheres.

- Meaningful transatlantic cooperation on China is limited by fundamentally different EU and US views on several issues. This includes whether to take a confrontational or mainly defensive approach to China. It is also affected by the fact that much of the EU autonomy and sovereignty agenda has been developed with an eye more on the US than on China. Nevertheless, there is room for cooperation in several policy areas and the change of administration in the US provides an ideal opportunity to pursue this.

Introduction

Against a backdrop of increasingly difficult economic and political relations, COVID-19 diplomacy and the impact of the US–Chinese trade dispute, the EU can no longer prevaricate in its approach to China. The country has become not only a foreign and economic policy challenge, but also a source of disagreement in the transatlantic relationship. While European policymakers and business leaders share many of the gripes that their American peers have uttered about Chinese economic practices, they lack an agreed common strategy for how to deal with these.

The economic relationship remains the main lens through which the EU views China. European businesses and many governments have seen, and still see, the Chinese market as an opportunity, owing to the country's size and growing income levels as well as its role as 'Europe's producer'. The economic relationship is also defined by the geopolitical context. This became clearer at the end of 2020 when the EU's conclusion of a Comprehensive Agreement on Investment (CAI) with China created a first point of contention with the incoming US administration and led to some tension among member states.

This paper is the first step in the Transatlantic Dialogue on China project[1] to facilitate exchange between the US and Europe on economic issues related to China. Given the rapidly shifting context, the increase in tensions between Europe and China, and the uncertainty over US policy on China under the Biden administration, it looks at EU policymaking on China to provide a clearer view of its direction and priorities. The paper describes how the EU and its member states see the economic relationship with China and how this is likely to develop in the context of the US–China rivalry.

Economic context

EU member states have different bilateral economic relationships with China, often reflecting the nature of their own economies. Understanding these differences provides a perspective on the incentives each country faces in its political interactions with China and with the EU. Countries with deep trading relations with China, particularly those with large export dependencies or those that have invested significant amounts of money there, have potentially strong domestic constituencies with an incentive either to favour a soft approach towards China or to use economic tools in an attempt to influence its policies.

1 RUSI and Chatham House (n.d.), 'The Transatlantic Dialogue on China', https://www.transatlantic-dialogue-on-china.rusi.org.

Given the geopolitical context, particularly the rivalry between the US and China and its spillover to other countries, it is also important to understand EU countries' different economic relations with both parties. Current relations and recent trends provide an indication of the EU's room for manoeuvre within the constraints created by this rivalry. With the Trump administration pushing a US economic decoupling from China, which included pressuring US allies to do the same, and the Biden administration not fully letting go of this idea but speaking of 'extreme competition' with China, European governments might feel pressure to make a choice between the two.

Government interventions, including lockdowns and travel restrictions, disrupted trade and investment flows.

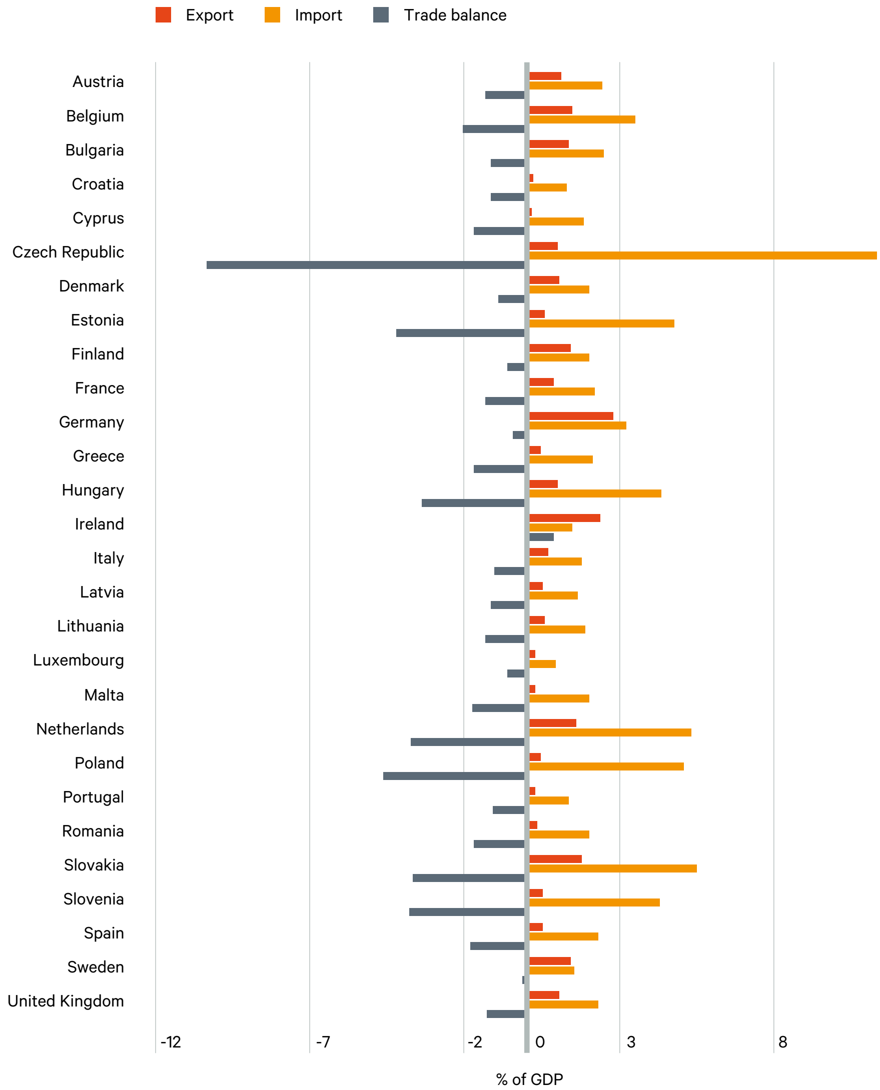
The data presented below have largely not been adjusted for the economic impact of the COVID-19 pandemic, when government interventions, including lockdowns and travel restrictions, disrupted trade and investment flows. The Chinese economy has recovered rapidly and helped drive exports for many countries – for instance China became Germany's largest export market in the second quarter of 2020.[2] Investment flows show a similar pattern. Foreign direct investment (FDI) into the US fell significantly in 2020, leading China to overtake it as the main FDI destination in 2020.[3] However, although some of the latest data points show a clear change from trends in recent years, this could have been driven by temporary disruptions and is not necessarily representative of how economic relations will develop after the pandemic.

Trade

All European economies have a substantial dependency on imports from China. This increased across the continent as manufacturing shifted to the country, particularly following its accession to the WTO in 2001. All European countries import significant amounts of goods from China, with Central European countries and those serving as ports for the rest of Europe, in particular Belgium and the Netherlands, standing out (see Figure 1). Continued growth in imports from China even during the COVID-19 crisis suggests this is not likely to change anytime soon. Goods exports from European countries to China remain a lot more modest, with those from Germany the only notable exception. As a result, all EU member states run trade deficits against China. This is in sharp contrast to their trade relationship with the US, with each country still exporting significantly more to the US than to China (See Figure 2).

2 Destatis (2021), 'Database of the Federal Statistical Office of Germany', https://www-genesis.destatis.de/genesis/online (accessed 11 Jun. 2021).
3 Hannon, P. and Jeong, E-Y. (2021), 'China Overtakes U.S. as World's Leading Destination for Foreign Direct Investment', Wall Street Journal, 24 January 2021, https://www.wsj.com/articles/china-overtakes-u-s-as-worlds-leading-destination-for-foreign-direct-investment-11611511200.

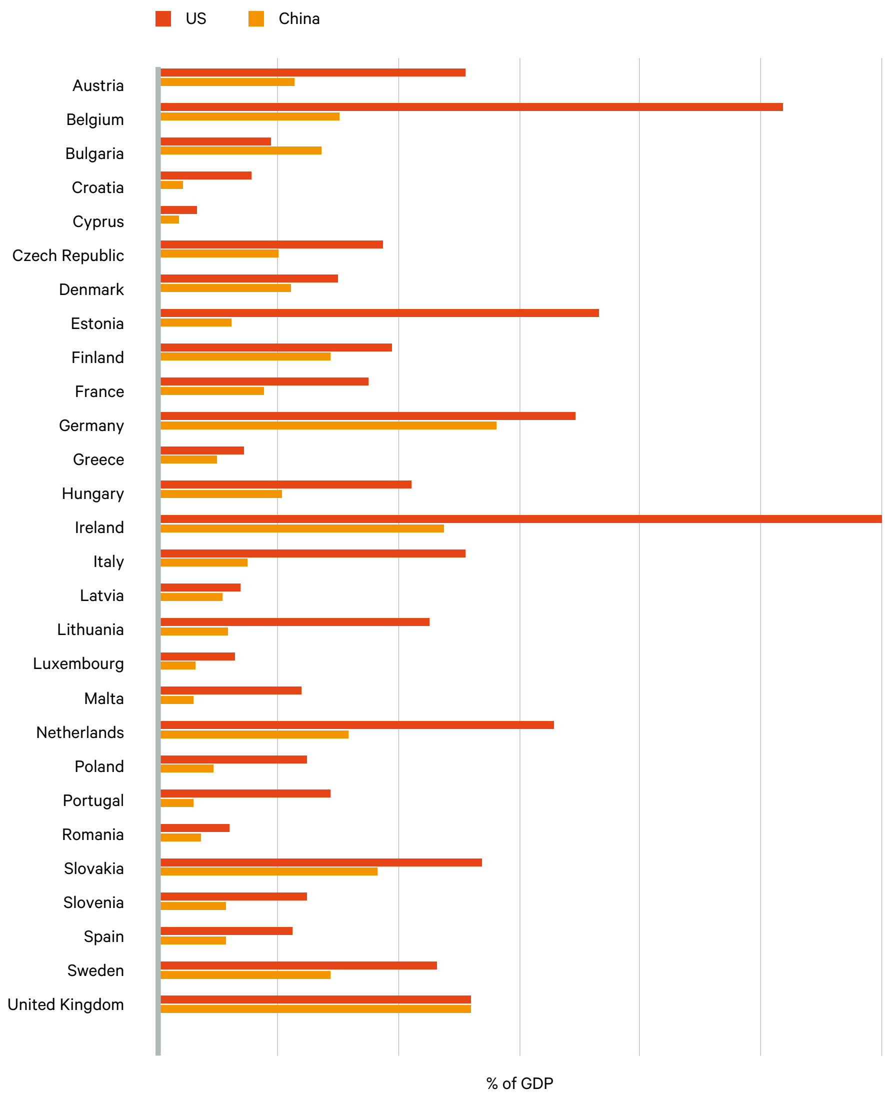
Figure 1. European countries' goods trade with China 2019



Sources: UN Comtrade (2021), 'UN Comtrade Database', https://comtrade.un.org (accessed 11 Jun. 2021); World Bank (2021), 'World Development Indicators', https://databank.worldbank.org/reports.aspx?source=2&series=NY.GDP.MKTP.CD&country= (accessed 17 Feb. 2021).

For most European economies, China is a production base and not a significant export market. Nevertheless, it was long held as an exciting prospect for exporters, particularly as it became richer and offered a potential market of hundreds of millions of middle-class consumers. This has benefited many companies, from producers of luxury products from countries such as France, Italy and Switzerland to German carmakers and European pharmaceutical firms.

Figure 2. European countries' goods exports to China and US 2019

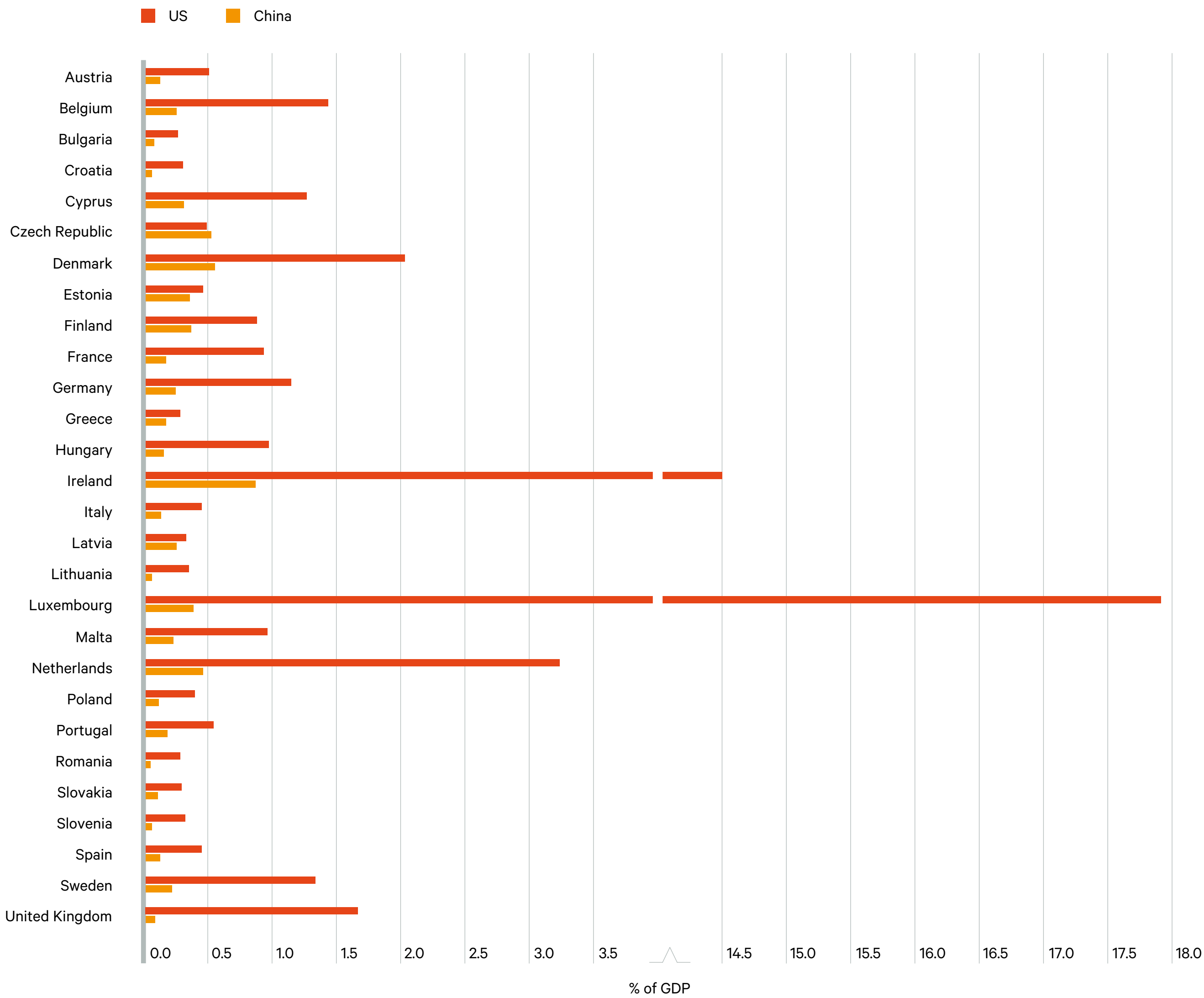


Sources: UN Comtrade (2021), 'UN Comtrade Database'; World Bank (2021), 'World Development Indicators'.

Significant barriers remain to exporting goods from Europe to China. First, distance continues to play a large role in determining trade flows, limiting the potential for much stronger links between them. Furthermore, despite Chinese promises of opening more sectors of the economy to foreign competition and to increase domestic consumption, and thus imports, progress in these areas has been slow. In recent years, the share of imports in China's GDP has fallen as the country sought to reshore supply chains. There are no signs that this trend is set to reverse. If anything, the direction of Chinese government policy, in particular the 'dual circulation' strategy – a plan put forward by the Chinese government in 2020 to expand domestic demand and reduce reliance on foreign markets while remaining open to international economic exchange – suggests a further turn towards economic self-reliance.[4]

4 *The Economist* (2020), 'China's "dual-circulation" strategy means relying less on foreigners', 7 November 2020, https://www.economist.com/china/2020/11/07/chinas-dual-circulation-strategy-means-relying-less-on-foreigners; Yu, J. (2021), 'Beijing sets new course', *The World Today*, 5 February 2021, https://www.chathamhouse.org/publications/the-world-today/2021-02/beijing-sets-new-course.

Figure 3. European countries' services exports 2018



Source: UN Comtrade (2021), 'UN Comtrade Database'; World Bank (2021), 'World Development Indicators'.

Services trade between Europe and China is even more limited, and for many countries dominated by tourism and other travel services.[5] Every EU member, as well as the UK, exports significantly more services to the US than to China (see Figure 3). This is the case even for those for which China is a significant market, which are the economies that tend to focus on financial services exports such as Ireland and Luxembourg. Chinese regulatory barriers to services trade tend to be a significant factor, as is distance, in limiting the potential for growth in this area.

5 UN Comtrade (2021), 'UN Comtrade Database', https://comtrade.un.org/data (accessed 5 Feb. 2021).

In recent years there has been a slight opening up of Chinese financial markets.[6] This has mainly benefited US firms so far. However, even they continue to face significant barriers as the opportunities are often limited to sectors where there are already dominant domestic players. Opportunities for European service providers to gain a larger share of the Chinese market in the coming years remain limited.

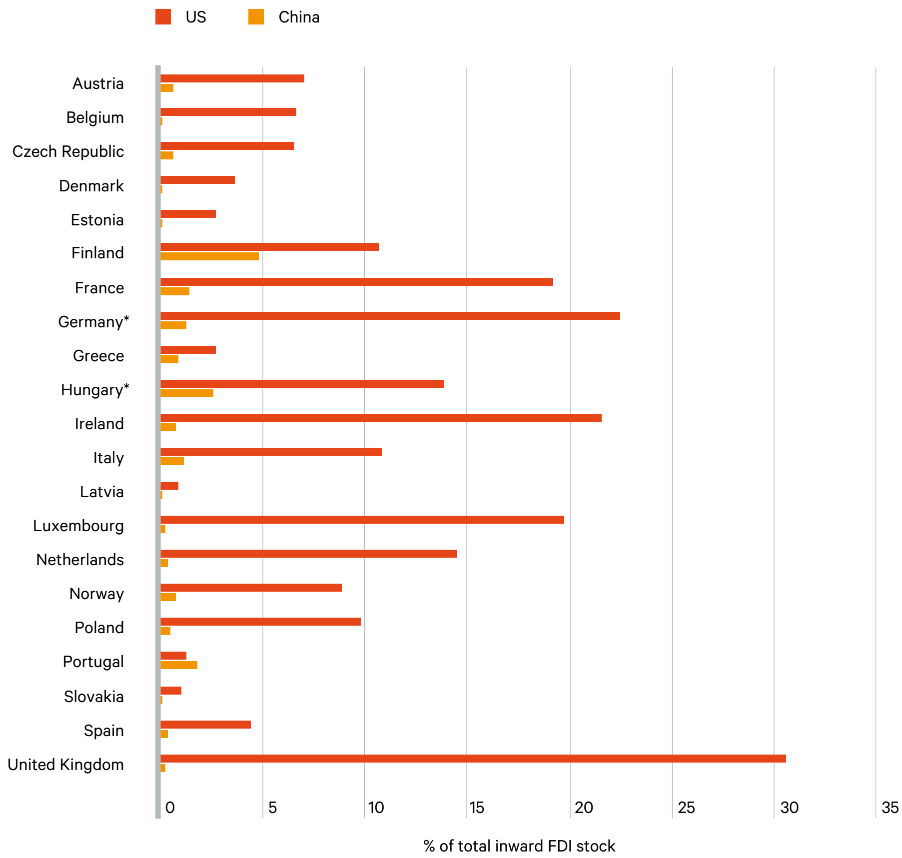
Investment

Chinese FDI in Europe has been unevenly distributed, with a focus on Western Europe. Until recently it was also small, in line with Chinese FDI in general (see Figure 4 below). A surge in 2016–17, combined with increasingly ambitious Chinese rhetoric on the country becoming the global leader in several high-tech manufacturing sectors, caused concern that this investment was being used to acquire technology with the aim of eventually outcompeting European producers, as part of the Made in China 2025 strategy. Since then, FDI from China has decreased but the issue remains on the radar of policymakers. For most European countries, Chinese investment makes up only a negligible share of all FDI and in most cases is dwarfed by US FDI.

Some EU countries, particularly in Central and Eastern Europe, have welcomed or sought Chinese FDI, with some signing up to China's Belt and Road Initiative in the hope of attracting investment. Sought-after greenfield investment flows have often failed to materialize, leading to disappointment in Europe. For example, the Czech Republic, which after a visit by President Xi Jinping in 2016 had high hopes of closer cooperation with China,[7] has become embroiled in diplomatic disputes with the country, in part due to the subsequent lack of investment.[8]

6 Lardy, N. R. and Huang, T. (2020), *China's Financial Opening Accelerates*, December 2020, Peterson Institute for International Economics, Policy Brief 20-17, Washington, DC, https://www.piie.com/sites/default/files/documents/pb20-17.pdf.
7 Muller, R. and Lopatka, J. (2016), 'Czech courtship pays off with landmark visit from Chinese leader', Reuters, 28 March 2016, https://www.reuters.com/article/us-czech-china/czech-courtship-pays-off-with-landmark-visit-from-chinese-leader-idUSKCN0WU01J.
8 Lau, S. (2020), 'Czech president to skip Beijing summit over China 'investment letdown'', *South China Morning Post*, 13 January 2020, https://www.scmp.com/news/china/diplomacy/article/3045917/czech-president-skip-beijing-summit-over-china-investment.

Figure 4. Sources of FDI stock in the EU in 2019



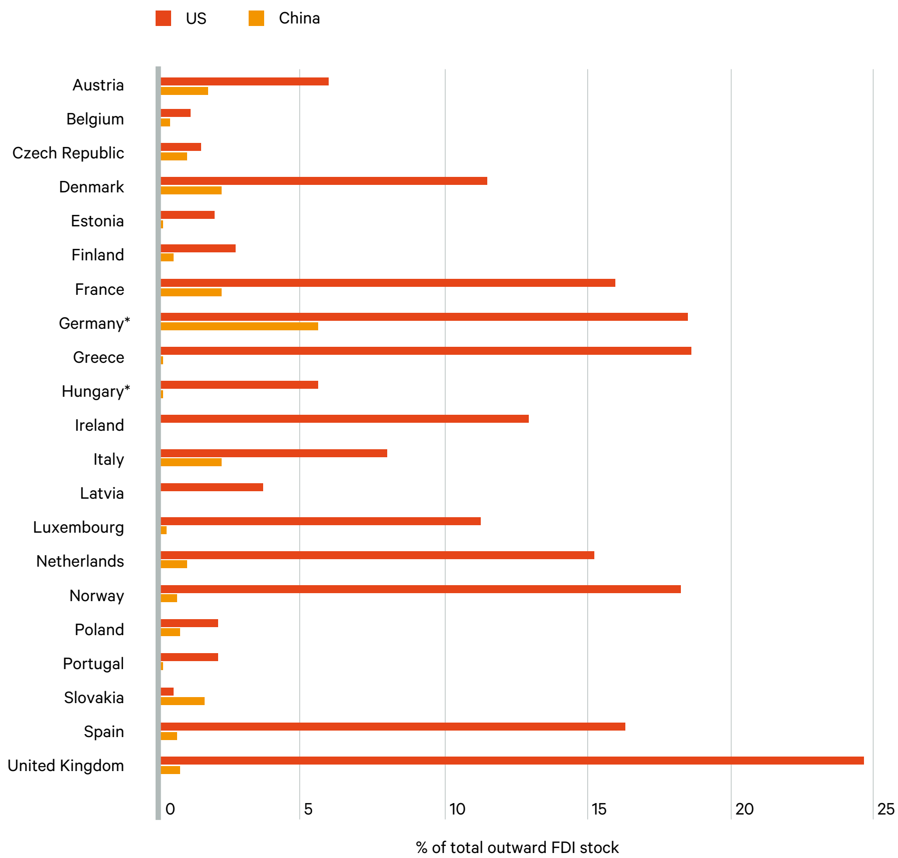
Sources: OECD (2021), 'Inward FDI stocks by partner country (indicator)', doi: 10.1787/a1818a82-en; Statistics Finland (2021), 'Foreign direct investment by immediate target and investor country', https://pxnet2.stat.fi/PXWeb/pxweb/en/StatFin/StatFin__yri__ssij/statfin_ssij_pxt_12gu.px (accessed 15 Jun. 2021).
Note: * 2018 data.

Despite the relatively low amounts of Chinese investment in Europe, there have been several politically sensitive investments in different European countries. Notable examples in recent years include the acquisition by Chinese companies of the Greek port of Piraeus and of Portugal's power grid.[9] Although such investments have raised questions over Chinese influence, and more broadly over the foreign ownership of critical infrastructure, other investments have arguably had a larger political influence. For example, the acquisition of a German robotics firm by a Chinese company contributed to a shift in perceptions of the Chinese economy and the potential competitive threat it poses to the Germany's economy.[10]

9 For discussions of how investments such as these have influenced European countries' China policy, see European Think Tank Network on China (2020), *Europe in the Face of US-China Rivalry*, https://merics.org/en/report/europe-face-us-china-rivalry.
10 Bickenbach, F. and Liu, W-H. (2018), 'Chinese Direct Investment in Europe – Challenges for EU FDI Policy', CESifo Forum, München, 19(4): pp. 15–22, https://www.cesifo.org/en/publikationen/2018/article-journal/chinese-direct-investment-europe-challenges-eu-fdi-policy.

Investment by European companies in China has a long history, mainly in the form of FDI as the Chinese government has limited portfolio investment flows. The European Economic Community signed a trade agreement with China in 1978, and several European firms were among the first to operate there when it began to open up its economy in the 1980s.[11] Large German firms have been among those most active in China. In 2018, the value of German FDI there was higher than that of the next five EU member states combined. For several large German firms, China is now their most important consumer market and is no longer just a manufacturing base for their western markets. For other European countries, China has been a lot less lucrative and their stake in its economy is thus significantly smaller. Even larger countries such as France and Spain have a small stake in the Chinese economy relative to their exposure to the rest of the world.

Figure 5. European outward FDI stock in 2019



Source: OECD (2021), 'Outward FDI stocks by partner country (indicator)', doi: 10.1787/b550f49f-en (accessed 15 Jun. 2021).
Note: *2018 data.

11 Eckhardt, J. (2020), 'Law and Diplomacy in EU–China Trade Relations: A Historical Overview', in Wu, C-H. and Gaenssmantel, F. (eds) (2019), *Law and Diplomacy in the Management of EU–Asia Trade and Investment Relations*, Routledge.

Technology

Despite its dependence on imports from China, the European economy is still more reliant on the US. Almost all European countries export significantly more to the US than to China and the economies of Europe and the US are deeply intertwined through extensive investment relations. Western European countries have a long history of deep economic and political integration with the US. Although transatlantic tensions have increased in recent years, and were exacerbated by the Trump administration, the US–EU connection remains close. This stands in sharp contrast with Europe's relatively new relationship with China, which focuses mainly on trade and for some countries on investment. One of the sectors where this is most visible is in technology.

The European technology market remains dominated by US firms. Large Chinese internet companies have little to no market share, with a few notable exceptions, including the telecoms firm Huawei and the social network TikTok. This is partly due to China playing catch-up but it also reflects fundamentally different views of how the internet should operate. China's closed, state-controlled model is incompatible with the European vision of an open internet with minimal state interference. Despite transatlantic differences over issues such as the governance of large technology firms, the European vision is significantly further removed from the Chinese authoritarian approach than that of the US.[12]

On the hardware side, the digital economies of Europe and China are more interwoven through global supply chains. For instance, the semiconductor industry is spread throughout the world, with crucial companies based in Europe.[13] However, this is not the case for other technologies, with Europe for instance lagging in artificial intelligence, and the combination of competition and conscious decoupling between the US and China is likely to widen this gap further. In part through diverging standards, there is a chance that the global technology scene will be split between the US and China. If this is the case, it is most likely that Europe will continue to gravitate towards the US.

The elephant in the room

By almost all measures, Germany has a deeper economic relationship with China than any other EU member. The value of German goods exported to the country in 2019 was equal to the combined exports to China of all other EU members, driven by Chinese demand for German capital goods, machinery and cars. This is also a reflection of the size of the German economy and its export dependence. Exports to China were equivalent to 2 per cent of Germany's GDP and made up 8 per cent of its exports. This was slightly higher than exports to the UK but still below those to the US.[14]

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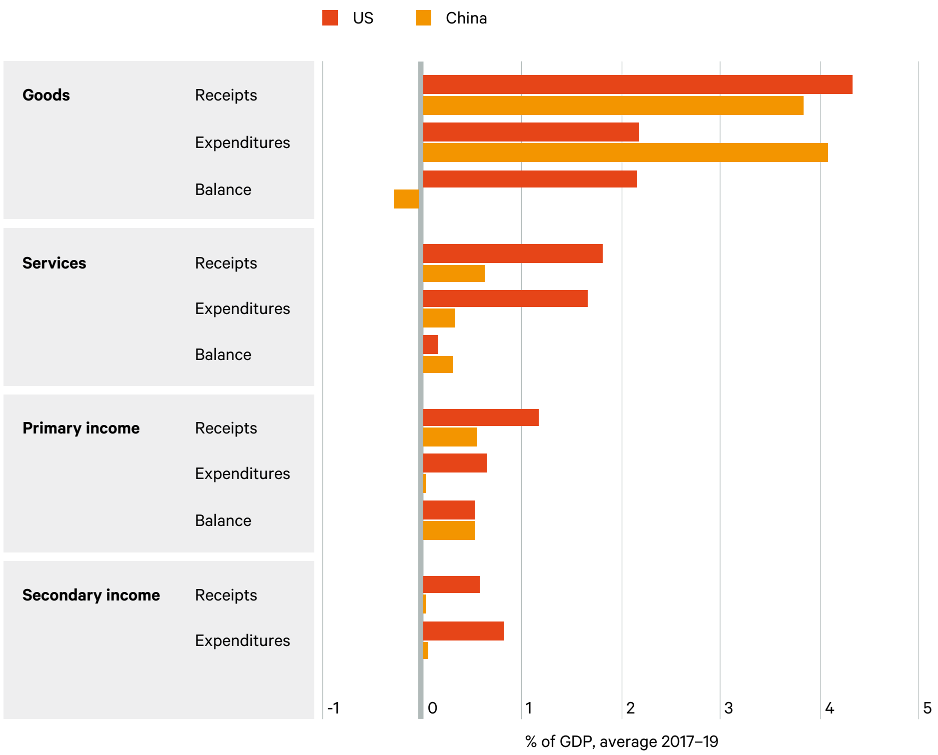
12 O'Hara, K. and Hall, W. (2018), *Four Internets: The Geopolitics of Digital Governance*, CIGI papers, https://www.cigionline.org/sites/default/files/documents/Paper%20no.206web.pdf.
13 Baisakova, N. and Kleinhans, J-P. (2020), *The Global Semiconductor Value Chain: A Technology Primer for Policy Makers*, Policy Brief, Stiftung Neue Verantwortung, https://www.stiftung-nv.de/de/publikation/global-semiconductor-value-chain-technology-primer-policy-makers.
14 Destatis (2021), 'Order of rank of Germany's trading partners', 18 February 2021, https://www.destatis.de/EN/Themes/Economy/Foreign-Trade/Tables/order-rank-germany-trading-partners.html.

Germany has in recent years run small current-account surpluses with China, resulting from the combination of relatively modest bilateral trade deficits against it and significant income streams arising from investments there. This is also a revealing metric when comparing the economic relations that Germany has with China and with the US as it captures all income flows. As Figure 6 shows, all income flows between Germany and the US, except for goods imports, are significantly larger than those between Germany and China. The German economy remains significantly more integrated with the US economy.

Nevertheless, many large and politically influential German firms are deeply integrated with and exposed to the Chinese economy, influencing the country's China policy. For instance, China has become the largest market for Volkswagen. This has not meant a significant boost to German exports, though, as the majority of Volkswagen's sales in China are produced locally. This includes production in the western province of Xinjiang, where the alleged use of forced labour in its supply chain has caused political difficulties for the company.[15] Volkswagen is increasing its exposure to the Chinese market through significant investment in electric mobility production there.[16]

Figure 6. German bilateral current-account balances



Source: Bundesbank (2021), 'Balance of payments (acc. Statistical series)', https://www.bundesbank.de/en/statistics (accessed 2 Feb. 2021).

15 BBC News (2020), 'China Muslims: Volkswagen says 'no forced labour' at Xinjian plant', 12 November 2020, https://www.bbc.co.uk/news/world-asia-china-54918309.
16 Moss, T. and Mou, M. (2020), 'Volkswagen Pours More than $2 Billion Into China's Electric-Car Industry', *Wall Street Journal*, 29 May 2020, https://www.wsj.com/articles/volkswagen-pours-more-than-2-billion-into-chinas-electric-car-industry-11590736755.

German firms continue to see significant opportunities in China and forecast stronger growth prospects there than in Europe and the US.[17] This is not to say that there have not been complaints from German business about China. Notably, in 2019, the Federation of German Industries (BDI) spoke out about China's economic practices.[18] There are differences between companies reliant on the Chinese market and those facing increasing competition from China, with representatives of the former denouncing the harsh tone adopted by the BDI.[19] Given the political weight of the industrial sector, Germany's economic interest in China is unlikely to change anytime soon, and this is going to continue to weigh heavily in its China policy.

European issues with China

Many European countries have primarily viewed relations with China as an economic opportunity. Following its entry into the World Trade Organization (WTO) in 2001, China was seen as a source of cheap manufacturing imports and as a destination for investment in manufacturing industries. While the extent of the latter differed significantly between countries, the former was true across Europe, and in line with views of other developed countries. As China developed, however, it also provided the lure of potentially the largest market of middle-class consumers for European businesses. At the same time, the implicit assumption behind much EU policy in recent decades was not only that China would converge economically with the West, but also that this would facilitate political convergence.

Market access

European businesses and policymakers have long been frustrated by limited market access in China. Many sectors have either not been open to foreign companies or only accessible through joint ventures with local partners. In the latter case, this often involves the forced transfer of technology as the price of doing business. There have also been related complaints over the protection of intellectual property in China and over requirements for participation or surveillance in companies by the Chinese Communist Party.

These concerns are fundamentally about a lack of reciprocity. The European market has been almost fully open to Chinese exports and investment, while this has not been the case in China. This is not a matter of specific barriers thrown up against European companies in China; it reflects China's development and growth model that depends on building up domestic industrial capacity in part by initially limiting foreign competition. This largely explains why relatively little progress has been made towards rectifying this.

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17 AHK Greater China (2021), 'Business Confidence Survey: Positive Development for German Businesses in China and High Expectations for EU-China Investment Agreement', press release, https://china.ahk.de/news/news-details/business-confidence-survey-2020-2021.
18 Federation of German Industries (2019), 'China – Partner and Systemic Competitor', https://english.bdi.eu/media/publications/#/publication/news/china-partner-and-systemic-competitor.
19 Nienaber, M. (2019), 'German industry demands tougher line on 'partner and competitor', Reuters, https://uk.reuters.com/article/uk-germany-china-industry-idUKKCN1P40YX.

European governments frequently highlight 'promise fatigue' when it comes to the Chinese government approach to reciprocity. Beijing has often promised to open up new sectors of the economy or to reduce barriers to foreign firms, including joint-venture or licensing requirements that effectively shut them out. Generally, the follow-up has been disappointing from the European perspective.

This has not stopped the EU from pursuing further market access in China. The business sector, possibly the most important constituency for policy on China in many member states, has taken a similar approach. Businesses have become more vocal about the need to protect against market distortions arising from Chinese economic practices.[20] Yet they continue to see potential in the Chinese market and tend to argue against a confrontational approach. They continue to invest in China, including a number of high-profile investments in 2020 including in electric mobility, and argue against economic decoupling. This is broadly in line with the approach of American businesses. Neither the impact of COVID-19 nor the trade war waged by the Trump administration on China have led them to consider moving manufacturing activity out of the country.[21] In fact, US financial firms have increased their business activities there.[22]

Businesses have become more vocal about the need to protect against market distortions arising from Chinese economic practices. Yet they continue to see potential in the Chinese market and tend to argue against a confrontational approach.

Chinese competition

The operating environment for companies in China is not the only issue for the EU. Governments also worry about the impact of Chinese operations in Europe and increasing competition from Chinese firms, often on what many policymakers and business representatives judge to be an unfair basis. This ranges from technology transfer through acquisitions of European firms to distortions of the single market through non-market support for firms with Chinese ownership and dumping of Chinese products. In recent years, a slowdown in Chinese FDI and the beefing up of investment-screening mechanisms throughout Europe have slightly reduced the urgency of this issue. Nevertheless, China has moved up the agenda for many European countries as it is increasingly seen as an economic competitor.

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20 For example, see BusinessEurope (2020), *The EU and China – Addressing the systemic challenge*, January 2020, https://www.businesseurope.eu/publications/eu-and-china-addressing-systemic-challenge.
21 Mitchell, T. (2020), 'US companies defy Trump's threats about 'decoupling' from China', *Financial Times*, 9 September 2020, https://www.ft.com/content/8d23d65b-ee20-4449-a615-e3d2a9b672f8.
22 Lockett, H. and Riordan, P. (2020), 'Investment bankers revel in bumper fees from Chinese groups in 2020', *Financial Times*, 17 December 2020, https://www.ft.com/content/bba86de5-1da4-4b5a-bb40-6ff71c18cb7b#comments.

European policymakers describe 2016 as a watershed, since then China has been an issue of growing importance.[23] Around this time it became increasingly clear that China was not content with remaining a low-end manufacturing base and aimed to compete in high-end manufacturing through its Made in China 2025 policy. Previously it had been mainly Southern Europe's economies that experienced the downsides of China's integration into the global trading system as, like certain areas of the US, they shed jobs as they struggled to compete, for instance, with textile imports.[24] China's pronouncements made clear it also aimed to outcompete the Northern European economies in their areas of strength, including Germany's industrial base.[25]

Chinese ambitions and major achievements in new fields such as artificial intelligence have fed into existing insecurities in Europe about its own position. According to the European Commission, 70 per cent of the global economic impact of artificial intelligence is likely to be concentrated in North America and China.[26]

Perceptions of unfair practices add to European worries over the increase in competition from Chinese firms moving higher up the value chain. These have faced accusations of gaining unfair advantages due to state support – through exports of subsidized goods and through financing advantages – as they increasingly ventured into international markets. The EU sees this as a potential distortion of the level-playing field and of the single market. Governments also worry about Chinese firms, often potentially with state support, buying European companies to acquire technological know-how.

Politics complicating mercantilism

Political disagreements between the EU and China complicate their economic relationship and this worsened as tensions between the two increased in the first half of 2021. European political leaders and civil society actors have long voiced concerns over the lack of democracy and respect for human rights in China. Developments in recent years have intensified these concerns as the treatment of ethnic minorities in Xinjiang and the crackdown in Hong Kong made headlines in the West. These issues may prevent both sides continuing along the well-trodden economic track as European civil society and parliaments have become increasingly vocal in their criticisms of Chinese actions. The perceived mishandling by China of the initial phase of the COVID-19 pandemic also led to a rise last year in unfavourable views of China across Europe.[27] As a result, several European firms have come under public and political pressure over their operations in China. Relations between European countries and China worsened further in

23 Based on author interviews with European officials, who wished to remain anonymous, March 2020.
24 See, for example, Pierce, J. and Schott, P. (2016), 'The Surprisingly Swift Decline of US Manufacturing Employment' *American Economic Review*, 106(7): pp. 1632–62; Branstetter, L., Kovak, B., Mauro, J. and Venâncio, A. (2019), *The China Shock and Employment in Portuguese Firms*, NBER Working Paper 26252, https://www.nber.org/papers/w26252.
25 See de La Bruyère, E. and Picarsic, N. (2020), *Made in Germany, Co-opted by China*, FDD Press, October 2020, https://www.fdd.org/analysis/2020/10/14/made-in-germany-co-opted-by-china.
26 European Commission (2018), 'USA-China-EU plans for AI: where do we stand?', Digital Transformation Monitor, January 2018, https://ati.ec.europa.eu/sites/default/files/2020-07/USA-China-EU%20plans%20for%20AI%20-%20where%20do%20we%20stand%20%28v5%29.pdf.
27 Silver, L., Devlin, K. and Huang, C. (2020), 'Unfavorable Views of China Reach Historic Highs in Many Countries', Pew Research Center,6 October 2020, https://www.pewresearch.org/global/2020/10/06/unfavorable-views-of-china-reach-historic-highs-in-many-countries.

2021 following the imposition of sanctions by the EU on a number of Chinese individuals connected to alleged human rights violations in Xinjiang. China responded with countersanctions, leading to the ratification of an already agreed investment agreement between the EU and China being put on hold (see below).

China's use of economic measures in response to what it perceives as political snubs has also affected European views of economic cooperation and competition with the country. It has complicated relationships between China and, among others, Norway, Sweden and Australia in recent years.[28] Even Germany has been affected, with the Chinese ambassador warning in 2019 of 'consequences' if it chose to exclude Huawei from its 5G rollout.[29] Wanting to avoid being punished by China might have led many EU countries to hold back from a more confrontational stance.

The interplay between economic and security policies creates further complications. This has been on full display in recent years in the discussion over whether to allow Huawei to participate in the rollout of 5G mobile telecom networks in Europe. A significant number of countries, often under pressure from the US, have decided to ban the company from doing so, usually on security grounds.[30] Although this was never made explicit, there are industrial policy considerations involved as well, with two of Huawei's main competitors being European firms. This spilled over into the CAI negotiations, with China reportedly having asked for certain market access to not apply to EU countries that have banned the company from their 5G rollouts.[31]

Formulating China policy in the EU

The EU's foreign economic relations are to a large extent governed at the union level. As a result, its approach to China requires the approval of disparate countries with different economic interests, threat perceptions and assessments of the urgency of the issue. That the differing national perceptions of the economic threat posed by China have changed only relatively recently has probably contributed to the fact that there is still no comprehensive EU China strategy. Despite the sizeable and increasing number of complaints about China, no coalition or member state has pushed for a more confrontational line. In 2019, the European Commission published a strategic outlook document, describing China as a partner, an economic competitor and a systemic rival. The latter term grabbed the headlines, but member states have been slow to use this more confrontational

28 See, for example, Reuters (2016), 'Norway, China normalize ties after Nobel Peace Prize row', 19 December 2016, https://www.reuters.com/article/us-norway-china/norway-china-normalize-ties-after-nobel-peace-prize-row-idUSKBN1480R4; Sheftalovich, Z. and Heath, R. (2021), 'Australia offers Europe a warning on a trade deal with China', *Politico*, 8 January 2021, https://www.politico.eu/article/autralia-europe-china-trade-deal-warning.
29 Bennhold, K. and Ewing, J. (2020), 'In Huawei Battle, China Threatens Germany 'Where It Hurts': Automakers', *New York Times*, 16 January 2020, https://www.nytimes.com/2020/01/16/world/europe/huawei-germany-china-5g-automakers.html.
30 Reuters (2020), 'Factbox: Huawei's involvement in 5G telecoms networks around the world', 20 October 2020, https://www.reuters.com/article/us-sweden-huawei-global-factbox/factbox-huaweis-involvement-in-5g-telecoms-networks-around-the-world-idUKKBN2751A1.
31 Bermingham, F. (2021), 'China tried to punish European states for Huawei bans by adding eleventh-hour rule to EU investment deal', *South China Morning Post*, 8 January 2021, https://www.scmp.com/economy/china-economy/article/3116896/china-tried-punish-european-states-huawei-bans-adding.

definition. They have to some extent left this to the European Commission, in part because it allows them to disavow any stronger language coming from Brussels when necessary. In that regard it was telling that the European Council did not specifically endorse the strategic outlook document in its subsequent meeting.[32] Basically all member states are pursuing what they consider a pragmatic policy towards China, considering it both a competitor and a partner.[33]

There is little hope among EU policymakers of being able to significantly shift Chinese economic practices, which provides further impetus for a strategy focused on internal change instead. Some, most significantly in the current German government, still hold out hope that further economic engagement will lead to changes, the *Wandel durch Handel* (change through trade) approach, though attitudes are even shifting in Germany.[34] Although a sentiment seemingly driving much German policy in recent years, it is not necessarily shared across the entirety of the political spectrum or even the business community. A change in political leadership following the German election in September 2021 might thus also lead to something of a rethink of the German government position. Similarly, most member states do not believe this to be realistic anymore, particularly in the Xi Jinping era with China doubling down on its authoritarian capitalist model, and this approach now widely characterized as naïve. Some of this approach nevertheless remains; for instance, in the CAI, through which European firms hope to gain additional market access with less interference in their operations in China and a dispute-settlement mechanism to deal with any breaches of Chinese promises. However, in part due to previous experiences, EU governments and business representatives remain doubtful that the eventual market opening will conform fully to these hopes and they do not expect full reciprocity within any realistic time frame. As a result, the implicit EU strategy is one of gaining small concessions from China and protecting its internal market.

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The pace of strategizing when it comes to China is slow, particularly at the level of member states. They have generally shown no urgency to do so or have aimed lower in terms of defining the strategic challenge and the response to it, compared to the attempts to do so at the EU level. National China strategies are rare. The Netherlands and Sweden are two prominent exceptions, but both

32 European Council (2019), 'European Council conclusions, 22 March 2019', press release, https://www.consilium.europa.eu/en/press/press-releases/2019/03/22/european-council-conclusions-22-march-2019.
33 Oertel, J. (2020), *The new China consensus: How Europe is growing wary of Beijing*, ECFR Policy Brief, 7 September 2020, https://ecfr.eu/publication/the_new_china_consensus_how_europe_is_growing_wary_of_beijing.
34 For a more thorough exploration of developments in German thinking on China, see Barkin, N. (2021), *Rethinking German policy towards China: Prospects for change in the post-Merkel era*, Chatham House Briefing, London, Royal Institute of International Affairs, https://www.chathamhouse.org/2021/05/rethinking-german-policy-towards-china.

have focused on maintaining economic relations in the face of a changing appreciation of the geopolitical and economic threat posed by a more assertive China.[35] Fundamentally, many member states are too small to expend much energy on China policy, which tends to be dealt with by the EU institutions and the larger member states. In line with the traditional balance of power within the EU and its economic interests, Germany in particular has set the agenda on China policy.

Member states wield a veto on EU foreign policy actions and this has been used particularly in regard to proposed EU actions against China related to human rights and international law, sparking concerns over a Chinese divide-and-rule strategy.[36] However, this is best understood in light of differences and disagreements within the EU. Member states have at times instrumentalized actual or potential economic and political relations with China – particularly concerning investments – in EU debates. The 17+1 Framework, through which China cooperates with 17 countries in Central and Eastern Europe, is an example of this. This is a way for these countries to access investment and trade opportunities from China, although the results have often been disappointing. By providing these countries with a potential alternative source of funding, this arrangement gave China a possible lever in negotiations within the EU on other topics. While some feared China was using the initiative to split the EU, participating countries were mainly using it as leverage in the pursuit of their own objectives within the EU. Over time, members were less interested in the format as it became less useful, leading to limited participation in the summits and Lithuania even withdrawing altogether.[37] Other cases, including countries like Greece and Portugal turning to Chinese investment when privatizing critical infrastructure, are better understood in the context of internal EU disputes than as a successful strategy on the part of China. EU countries, like Italy, that signed up to the Belt and Road Initiative similarly did so in part with an eye on internal EU debates.[38] Thus, while China has regularly featured in EU debates, it was not always as the primary concern.

In part this reflects the limited amount of policymaking within the EU context that is explicitly aimed at China, but this does not mean that nothing has been done to counter some of the unwanted Chinese economic practices. In some areas, these have led to direct responses by the EU through regular trade defence instruments. For instance, in recent years, the EU has applied anti-dumping tariffs on some Chinese imports, including steel and bicycles.[39] In general, however, China was

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35 Government of Sweden (2019), *Approach to matters relating to China*, government communication, https://www.government.se/4adb19/contentassets/e597d50630fa4eaba140d28fb252c29f/government-communication-approach-to-matters-relating-to-china.pdf; Government of the Netherlands (2019), *The Netherlands and China: a new balance*, https://www.government.nl/documents/policy-notes/2019/05/15/china-strategy-the-netherlands--china-a-new-balance.
36 Emmott, R. and Koutantou, A. (2017), 'Greece blocks EU statement on China human rights at U.N.', Reuters, 18 June 2017, https://www.reuters.com/article/us-eu-un-rights/greece-blocks-eu-statement-on-china-human-rights-at-u-n-idUSKBN1990FP; Chalmers, J. and Emmott, R. (2021), 'Hungary blocks EU statement criticising China over Hong Kong, diplomats say', Reuters, 16 April 2021, https://www.reuters.com/world/asia-pacific/hungary-blocks-eu-statement-criticising-china-over-hong-kong-diplomats-say-2021-04-16.
37 Lo, K. (2021), 'Lithuania quit 17+1 because access to Chinese market did not improve, its envoy says', *South China Morning Post*, 1 June 2021, https://www.scmp.com/news/china/diplomacy/article/3135522/lithuania-quit-171-because-access-chinese-market-did-not.
38 See Bindi, F. (2019), 'Why Did Italy Embrace the Belt and Road Initiative', Carnegie Endowment for International Peace, 20 May 2019, https://carnegieendowment.org/2019/05/20/why-did-italy-embrace-belt-and-road-initiative-pub-79149.
39 See the European Commission's trade defence investigations database: http://trade.ec.europa.eu/tdi/case_history.cfm?id=271&init=1532.

not a challenge that policymakers cared that much about until recently, unless it was directly linked to specific policy objectives such as increasing incoming FDI. China policy also mostly resided with national and EU civil servants, with relatively little involvement by politicians, possibly due to the lack of public and political interest. This approach will be increasingly unsustainable given the geopolitical environment of increasing competition between the US and China.

The EU's China policy

Since economic interests drive EU policymaking towards China, especially in trade and investment, some member states are more prominent and engaged in the process than others. The EU, and in particular Germany, continues to see potential benefits from China's economic rise. The EU's overall economic policy response to the challenge China presents effectively consists of a set of defensive and mercantilist economic policy measures, which are guided by a broader geopolitical vision of the EU as a neutral actor between the US and China.

Pursuing strategic autonomy

The combination of a mercantilist approach to China, including attempts to gain small concessions from it on market access, and a focus on protecting the integrity and strength of the single market is in part informed by the geopolitical assessment made by European leaders. A long process by the US of shifting its foreign policy focus from Europe towards Asia, symbolized by the 'pivot' under the Obama administration, was followed by the Trump administration's actions that deeply undermined European trust in the transatlantic relationship. The latter included threats from Trump to withdraw the US security guarantee for Europe and a low-level economic conflict through the imposition of tariffs. These, and in particular the threat of tariffs on German cars, confirmed for Chancellor Angela Merkel that 'the era in which we could fully count on others is somewhat over'.[40] Meanwhile, for France, which has always seen the EU as a lever for its own influence in the world, this reinforced the importance of building a more independently capable EU in geo-economics and security.

This has led the EU to pursue 'strategic autonomy', which the European Council in 2016 defined as the 'capacity to act autonomously when and where necessary and with partners wherever possible'.[41] Related to this is the idea of 'economic sovereignty', or the capacity for the EU to wield economic power.[42] While economic sovereignty is more relevant in the area of trade and investment, it is often used

40 Chhor, K. (2017), ' Merkel's blunt speech sparks fears of rupture in transatlantic pact', France24, 30 May 2017, https://www.france24.com/en/20170529-merkel-comments-fears-fracturing-transatlantic-usa-alliance-trump-eu-brexit.
41 Council of the European Union (2016), 'Council conclusions on implementing the EU Global Strategy in the area of Security and Defence', 14 November 2016, https://www.consilium.europa.eu/media/22459/eugs-conclusions-st14149en16.pdf.
42 On the confusion between strategic autonomy and economic sovereignty, see Kundnani, H. (2021), 'European Sovereignty Without Strategic Autonomy', Chatham House Expert Comment, 19 January 2021, https://www.chathamhouse.org/2021/01/european-sovereignty-without-strategic-autonomy.

interchangeably with strategic autonomy and has less influence in terms of guiding policy. France has always approached strategic autonomy more from the security perspective than Germany, which is mainly driven by economic considerations.

A strategically autonomous EU would sit as a neutral third pillar between China and the US within the global order. In the economic sphere it would in effect attempt to be a very big and more powerful Switzerland, remaining neutral and maintaining good economic relations with all sides. This does not mean it would be equidistant between the US and China – the EU is closer to the US than to China ideologically, politically and economically – but it does mean avoiding becoming mixed up in the geopolitical great-power competition between them. In crude terms, China would be the world's economic superpower and the US would remain the security superpower while the EU would be a regulatory superpower. By contrast, the UK largely sees a two-pillar world and has aligned more closely with the US confrontational approach to China policy, including on the issue of Huawei and in response to the crackdown in Hong Kong.

A strategically autonomous EU also means attempting to benefit economically from integration with China and the US. Economic decoupling from China, as raised by the Trump administration, has never been a goal for the EU or any member state. The CAI was negotiated to some degree in the context of strategic autonomy. It exemplifies the features of EU debates on China policy, with France emphasizing the strategic autonomy angle and Germany focusing on market access.

The idea of Europe as a neutral third pillar between the US and China permeates almost all areas of the EU's international economic policymaking. A prime example of this goal to achieve economic sovereignty is the attempt to increase the international role of the euro.[43] This is aimed firstly at the US and the power it has due to the international role of the dollar. But it is also in view of China's attempts to internationalize the renminbi, including through a digital currency, which the European Commission and the European Central Bank are now also investigating.[44]

The China toolbox

In response to its market access and competition considerations the EU has in recent years built up a toolbox of mainly defensive economic policies. Although not explicitly in response to China, its framework for screening FDI, which became operational in late 2020, features prominently among these measures. The main aim of the framework is to enable better information sharing on foreign investment screening, which is still done through national instruments, and it allows the European Commission to submit an opinion in certain cases.[45] Another modest instrument is the 5G toolbox introduced in early 2020 in response to member

43 European Commission (2021), 'Commission takes further steps to foster the openness, strength and resilience of Europe's economic and financial system', press release, https://ec.europa.eu/commission/presscorner/detail/en/IP_21_108.
44 European Commission and European Central Bank (2021), 'Joint statement by the European Commission and the European Central Bank on their cooperation on a digital euro', 19 January 2021, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/210119-ec-ecb-joint-statement-digital-euro_en.pdf.
45 European Commission (2020), 'EU foreign investment screening mechanism becomes fully operational', press release, 9 October 2020, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867.

states adopting differing lines towards the inclusion of Huawei in their respective 5G rollouts. The toolbox incorporates measures that member states can use to ensure a coordinated approach to the security of 5G networks but does not exclude Huawei involvement.[46] In mid-2021, the European Commission put forward a proposal for a regulation to tackle distortions of the level playing field that arise from subsidies provided by foreign governments to firms operating within the single market.[47] These specific instruments all complement existing trade defence instruments such as anti-dumping and anti-subsidy measures. The EU also considers its efforts to reform multilateral systems, such as the WTO, as part of this approach. As in the past, it hopes to use these mechanisms to exert pressure on China to comply with the rules of the multilateral trading regime.

The challenge posed by China has also influenced thinking within the EU on how to structure the single market. For instance, in early 2019, France and Germany put forward a proposal for more investment in new technologies and for changes to competition rules to enable the creation through mergers of larger firms to compete with industrial giants from China and the US.[48] This has not led to concrete steps yet but indicated a change in EU attitudes. Overall, the economic policy response to the China challenge is mainly internally focused and lacks the aggressive character of the measures taken by the Trump administration or even the only slightly less confrontational approach of the Biden administration. For example, beyond existing restrictions on exports of dual-use items, the EU does not see restrictions of high-tech exports as part of its China strategy.[49] Whereas the US has attempted to limit Huawei's access to semiconductor technology through export controls, it took US pressure for the Netherlands to retract an export licence for the sale to a Chinese firm of highly advanced equipment critical to semiconductor production. This goes some way to explaining why the set of instruments and measures aimed directly and indirectly at China has not led to significant tensions. However, as the toolbox grows it could lead to further political spats following those in the first half 2021.

A risky strategy

The many small measures in the EU's toolbox should partly protect the single market from distortions resulting from China's economic model. However, in most cases their impact is likely to be limited. For instance, investment-screening relies on member states to use their national policy mechanisms, which some lack

46 European Commission (2020), 'Cybersecurity of 5G networks – EU Toolbox of risk mitigating measures', https://ec.europa.eu/digital-single-market/en/news/cybersecurity-5g-networks-eu-toolbox-risk-mitigating-measures.
47 European Commission (2021), 'Foreign subsidies', https://ec.europa.eu/competition/international/overview/foreign_subsidies.html.
48 For the Franco-German proposal, see Federal Ministry for Economics and Technology (2019), 'A Franco-German Manifesto for a European industrial policy fit for the 21st Century', https://www.bmwi.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.pdf%3F__blob%3DpublicationFile%26v%3D2.
49 See Duchâtel, M. (2021), 'The Weak Links in China's Drive for Semiconductors', Policy Paper, Institut Montaigne, January 2021, https://www.institutmontaigne.org/en/publications/weak-links-chinas-drive-semiconductors.

beyond tools aimed at industries such as defence.[50] Deep divisions remain within the EU over the direction of its industrial policy, with the Franco-German proposal for reform yet to be followed up. The introduction of the 5G toolbox did not lead to a common approach, with some countries having effectively banned Huawei from their 5G networks while others, notably Germany, look set to effectively allow it.[51] A new instrument to counter foreign subsidies might be effective but would, at best, counter a relatively small problem. Efforts to reform the multilateral trading system through the WTO and use this to influence Chinese economic and trading practices are also likely to prove difficult, as similar efforts have been largely unsuccessful for decades and face structural obstacles.[52] Even if many of these measures achieve their intended effect, they would still constitute a strategy reliant on incremental policy changes.

Even if the EU's efforts towards achieving economic sovereignty prove more successful than they have so far, the strategy itself might prove to be a risky one.

Meanwhile, efforts to strengthen the EU's economy, and thereby increase its resilience to foreign interference, will run up against the same political hurdles that have hampered economic reform for a long time. The internationalization of the euro is a prime example in this regard. This has been an EU goal since well before China became a significant issue, but requires changes to economic policy that have so far proven impossible, including the supply of a sufficient amount of safe financial assets, particularly government bonds.[53] In other policy areas, including industrial policy and fiscal policy, similar political and other hurdles complicate the effort to achieve economic sovereignty. The EU's willingness and ability to achieve a meaningful form of strategic autonomy or economic sovereignty thus remains in question. Already in the defence sphere the EU is under threat from the low level of spending and the preference, especially of eastern member states, to continue working through the NATO framework.[54] Even if the EU's efforts towards achieving economic sovereignty prove more successful than they have so far, the strategy itself might turn out to be a risky one.

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50 European Commission (2021), 'List of screening mechanisms notified by Member States', https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf.
51 Thomas, B. (2021), 'What Germany's new cyber security law means for Huawei, Europe and NATO', ECFR Note from Berlin, 5 February 2021, https://ecfr.eu/article/what-germanys-new-cyber-security-law-means-for-huawei-europe-and-nato.
52 Schneider-Petsinger, M. (2020), *Reforming the World Trade Organization: Prospects for Transatlantic Cooperation and the Global Trade System*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2020/09/reforming-world-trade-organization.
53 See Capolongo, A., Eichengreen, B. and Gros, D. (2020), 'Safely increasing the supply of safe assets: Internationalising the euro in the age of COVID-19', VoxEU, 23 October 2020, https://voxeu.org/article/internationalising-euro-age-covid-19.
54 Barigazzi, J. (2020), 'Low defense spending puts strategic autonomy at risk, EU review says', Politico, 20 November 2020, https://www.politico.eu/article/low-defense-spending-puts-strategic-autonomy-at-risk-eu-review-says.

The main risk comes from whether the US and China will grant the EU the leeway to not make a choice between them. Up until now the EU has largely been able to triangulate between the two countries, some small spats and frustrations notwithstanding. Particularly if the dispute between the US and China deepens into something akin to an economic cold war, both might use different pressure points on the EU in attempts to force it into alignment. The EU is unlikely to have the economic or security strength to fully maintain neutrality. China has already in the past used economic measures in political disputes and further European economic integration will increase its leverage. Last year, despite having a free-trade agreement with China, Australia was the victim of politically motivated trade sanctions.[55] In March, in retaliation for EU sanctions on Chinese officials over alleged human rights abuses in Xinjiang, China imposed sanctions on several European individuals and entities, including several members of the European parliament and national legislatures.[56] Meanwhile, the US has shown itself willing to use sanctions on third countries even when they affect allies, as with Iran, which triggered the EU to work on its economic sovereignty strategy. Early in 2021, the US warned European companies that they face sanctions if they work on the Nord Stream 2 gas pipeline between Russia and Europe, which the US objects to but the economic benefits of which Germany refuses to forego.[57]

So far China policy has not been particularly contentious within the EU but joining it with the strategic autonomy agenda risks creating division. Most member states have not been that engaged in China policy and it has not caused significant splits between them, but they have different priorities in their relationship with China and with the US. While for some, not least Germany, the main objective is mercantilism, for others, including many in Central and Eastern Europe, the relationship with China is much more instrumental politically and economically while the relationship with the US is of more fundamental importance owing to the security guarantee. Not all are looking to reduce their security dependence on the US. For example, Poland and the Baltic states are still exposed to a significant threat from Russia, while Germany is not. This shapes respective geopolitical calculations. As a result, in a disagreement with the US over a confrontational approach to China, there could be divisions within the EU if Washington uses its security guarantee as a lever.

The different levels of member states' economic integration with the US and China will continue to influence EU decision-making. Economic growth forecasts support further economic engagement with China over the coming decade; the OECD expects the German and US economies to grow by about 50 per cent in nominal US dollar terms and the Chinese economy to expand by around 150 per cent.[58]

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55 Kassam, N. (2020), 'Australia's Relationship With China Can Survive – but It Won't Be The Same Again', Lowy Institute Commentary, 28 December 2020, https://www.lowyinstitute.org/publications/australia-relationship-china-can-survive-it-wont-be-same-again.
56 Ministry of Foreign Affairs of the PRC (2021), 'Foreign Ministry Spokesperson Announces Sanctions on Relevant EU Entities and Personnel', press release, https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2535_665405/t1863106.shtml.
57 Gardner, T. and Psaledakis, D. (2021), 'U.S. tells European companies they face sanctions risk on Nord Stream 2 pipeline', Reuters, 13 January 2021, https://www.reuters.com/article/us-usa-nord-stream-2-sanctions-exclusive-idUSKBN29I0CN.
58 These forecasts were made before the COVID-19 pandemic but, given their long-term nature, its impact is unlikely to significantly change the broad trends. See OECD (2018), 'Economic Outlook No 103 – July 2018 – Long-term baseline projections', July 2018, https://stats.oecd.org/Index.aspx?DataSetCode=EO103_LTB.

However, China's focus on its domestic economy as opposed to opening up and the increasingly bifurcated technology landscape, together with closer ideological and political alignment, is likely to continue to draw EU countries closer to the US than to China. While wishing to remain neutral between the two is understandable, particularly from an economic perspective for countries such as Germany, this is likely to turn out to be a difficult balancing act.

The CAI case study

Many of the issues discussed above, including German dominance in the EU's China policy and the interplay between economic objectives and political barriers, were prominent in the EU's attempts to conclude an investment agreement with China, the EU–China Comprehensive Agreement on Investment (CAI). The CAI has the potential to support further European investment in China by opening up several sectors and easing restrictions on EU companies operating in China.[59] From the EU perspective the aim is to ensure a level playing field with American firms that received some of the same access through the agreement that the US and China reached in early 2020, and to compete with Chinese companies. However, significant uncertainty remains over whether this will happen, not least as the CAI still needs to be approved by the European Council and the European parliament. The agreement would in any case be likely to benefit those member states that are already heavily invested in the Chinese economy. German firms, particularly in manufacturing and the automotive sector, once again stand to benefit from the loosening of foreign ownership restrictions.[60] It was therefore not surprising that Germany, together with France, was among the driving forces getting the agreement over the line in late 2020.[61] Some smaller member states objected to this, but not enough to derail the process.[62]

Since then, the process of ratifying the agreement has highlighted the challenges posed by the increasingly difficult political and geopolitical environment for a European China policy that prioritizes economic gains. First, the increase in attention and stronger stances on China policy from national legislatures and the European parliament risks complicating the ratification of the CAI, which the latter must do. In the CAI, China has agreed to 'make sustained and continuous efforts' to ratify the International Labour Organization conventions on forced labour. Although not many in Europe think this is likely to happen anytime soon, the provisions are crucial to gain political support for the CAI.[63] This was further complicated in early 2021 when China sanctioned several members of the

59 European Commission (2020), 'EU and China reach agreement in principle on investment', press release, 30 December 2020, https://trade.ec.europa.eu/doclib/press/index.cfm?id=2233.
60 Bradsher, K. (2018), 'China Loosens Foreign Auto Rules, in Potential Peace Offering to Trump', *New York Times,* 17 April 2018, https://www.nytimes.com/2018/04/17/business/china-auto-electric-cars-joint-venture.html.
61 Von der Burchard, H. (2020), 'Merkel pushes EU-China investment deal over the finish line despite criticism', Politico, 29 December 2020, https://www.politico.eu/article/eu-china-investment-deal-angela-merkel-pushes-finish-line-despite-criticism.
62 Elmer, K. (2021), 'China-EU investment deal: smaller countries question whether France and Germany have their best interests at heart', *South China Morning Post*, 16 January 2021, https://www.scmp.com/news/china/diplomacy/article/3118009/china-eu-investment-deal-smaller-countries-question-whether.
63 See Godement, F. (2021), 'Wins and Losses in the EU-China Investment Agreement', Policy Paper, Institut Montaigne, January 2021, https://www.institutmontaigne.org/en/publications/wins-and-losses-eu-china-investment-agreement-cai.

European Parliament in retaliation for EU sanctions on Chinese officials alleged to be involved in human rights violations in Xinjiang, which has created further uncertainty for the CAI's ratification.[64]

The CAI debate also highlights the complicating factor of the transatlantic relationship and how historical differences in the extent of the transatlantic orientation of EU members are still on display. In the final stages of the CAI negotiations, when the process unexpectedly sped up due to new concessions from China, the Biden transition team urged the EU to wait until the new US administration was in place before concluding the agreement.[65] However, France and Germany decided that the concessions by China – which were likely driven by a desire to split the transatlantic alliance before the new administration took office – were unlikely to be on offer later on and took the deal. This was despite the fact that some member states – with less invested in China than Germany and less interest in strategic autonomy than France, such as the Netherlands, or those that were more dependent on the US security guarantee, such as Poland – would have preferred to wait.[66]

Transatlantic cooperation

The change of US administration in 2021 offers more room for EU–US cooperation on China. In their confirmation hearings, Secretary of State Antony Blinken and Trade Representative Katherine Tai spoke of the US relationship with China as having adversarial, competitive and cooperative aspects – similar to the EU's assessment of its own relationship with China.[67] The Biden administration has also been vocal about its wish to work with allies on China and other global challenges, in contrast to the Trump administration.[68] At the same time, an assertive US approach to China retains bipartisan support.

The primacy of the strategic autonomy agenda and its implications for how the EU sees its position in the world complicates transatlantic cooperation on China because for the most part it has been formulated in response to the US. European leaders have largely welcomed the pledges by the Biden administration

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64 Brunsden, J. and Yang, Y. (2021), 'Sanctions row threatens EU-China investment deal', *Financial Times*, 24 March 2021, https://www.ft.com/content/6b236a71-512e-4561-a73c-b1d69b7f486b.
65 Sullivan, J. (@jakejsullivan) (2020), 'The Biden-Harris administration would welcome early consultations with our European partners on our common concerns about China's economic practices.', tweet, 22 December 2020, https://twitter.com/jakejsullivan/status/1341180109118726144?lang=en (accessed on 15 Feb. 2020).
66 See Brouwers, A. (2021), 'Minister Kaag: EU had bij investeringsakkoord met China moeten wachten op aantreden Biden' [Minister Kaag: EU should have waited for Biden administration to take office with investment agreement with China], De Volkskrant, 5 February 2021, https://www.volkskrant.nl/nieuws-achtergrond/minister-kaag-eu-had-bij-investeringsakkoord-met-china-moeten-wachten-op-aantreden-biden~b1d424e4; Tatlow, D. K. (2021), 'The EU-China Comprehensive Agreement on Investment', Online Commentary, German Council on Foreign Relations, 19 January 2021, https://dgap.org/en/research/publications/eu-china-comprehensive-agreement-investment-cai.
67 See Roche, E. (2021), 'US secretary of state nominee sees strong foundation for bipartisan China policy', mint, 20 January 2021, https://www.livemint.com/news/world/us-secretary-of-state-nominee-sees-strong-foundation-for-bipartisan-china-policy-11611146990786.html; Tai, K. (2021), 'Opening Statement of Ambassador-designate Katherine Tai Before the Senate Finance Committee', Office of the United States Trade Representative, 24 January 2021, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/february/opening-statement-ambassador-designate-katherine-tai-senate-finance-committee.
68 Biden, J. (2021), ' Remarks by President Biden on America's Place in the World', speech, 4 February 2021, https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/02/04/remarks-by-president-biden-on-americas-place-in-the-world.

to work together with allies, as with Biden saying that he will not remove the tariffs on imports from China until he has conferred with them. However, when the European Commission put forward a plan for a 'new transatlantic agenda for global change' in December 2020, it did not speak of anything like a confrontational approach to China.[69] Instead it reiterated that China is a partner, economic competitor and systemic rival of the EU and pointed to the EU–US Strategic Dialogue agreed between High Representative for Foreign Affairs and Security Policy Josep Borrell and the Trump administration, which the current administration is set to continue.

This is not to say that there are not areas for transatlantic cooperation in the economic sphere, as the European Commission set out in its agenda and in the context of the recent increase in tensions between China and the EU. In recognition of the stronger compatibility and deep integration of their technology sectors, the EU has proposed significant cooperation with the US as 'tech allies' and the EU and US confirmed a willingness to work together in this area during their summit in June 2021.[70] Behind this is the fear that future technology standards will be set by China, with its very different vision for the openness of the internet. Even here, significant barriers to successful cooperation remain, not least EU frustration with the dominance of the US tech sector and its plans for policies such as digital taxes aimed at large US tech firms. Early in 2021, the EU and the US separately announced plans for significant investment in semiconductor production capacity, partly in response to the domination of this sector by Taiwan and China's plans to increase its own capacity.[71]

There is limited room for EU–US cooperation in regard to China in trade and investment policy.

There is limited room for EU–US cooperation in regard to China in trade and investment policy. The aggressive measures employed by the Trump administration, including the tariff policy that has not been repudiated by the Biden administration, will not find any support in Europe. In June 2021, the EU–US Trade and Technology Council (TTC) agreed to coordinate in a number of policy areas, including growing the bilateral trade and investment relationship, coordination on internal standards development and seeking common ground and strengthening global cooperation on technology, digital issues and supply chains.[72] However, it remains to be seen whether this will lead to concrete action beyond the significant number of coordination instruments set out in these plans.

69 European Commission (2020), 'A new EU-US agenda for global change', Joint Communication to the European Parliament, the European Council and the Council, 2 December 2020, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2279.
70 Ibid., p. 5; European Council (2021), 'EU-US Summit Statement', press release, 15 June 2021, https://www.consilium.europa.eu/en/press/press-releases/2021/06/15/eu-us-summit-statement-towards-a-renewed-transatlantic-partnership.
71 Vincent, J. (2021), 'EU aims to double chip manufacturing amid growing fears about 'digital sovereignty'', 10 March 2021, https://www.theverge.com/2021/3/10/22322860/eu-semiconductor-chip-supply-double-output-2030-global-compass-investment.
72 European Council (2021), 'EU-US Summit Statement', press release, 15 June 2021, https://www.consilium.europa.eu/en/press/press-releases/2021/06/15/eu-us-summit-statement-towards-a-renewed-transatlantic-partnership.

At the same time the two parties reiterated their willingness to work together at the global level to reform the WTO. This could be used to counter unwanted Chinese trading practices, in part because it is a largely costless option for the EU.[73] However, due to US concerns about the WTO and the need to engage its largest members in any reform efforts, among other things, the outlook on this front is not positive. A final option would be for the EU and US to form a trading bloc and thereby export their standards to the rest of the world. But as their failure to conclude the Transatlantic Trade and Investment Partnership (which would have helped them set global trading standards) showed, their differences remain a hindrance to effective cooperation at this level. Meanwhile, other parts of the world are pushing forward with this strategy through large-scale trade agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which the UK is now looking to join.[74] There is more potential for transatlantic standard-setting in the technology sphere, as evidenced by the suggestions in this direction from the European Commission, but even here significant hurdles remain.

Effective transatlantic cooperation on China in trade and investment is therefore likely to continue to be hindered by the fundamentally different world views and policy preferences of the EU and the US. Furthermore, divergences among EU members will create additional complications as some would prefer a continuation of the mercantilist approach, some continue to value the traditional transatlantic relationship, and others prefer to pursue full strategic autonomy. There is room, and an offer from the EU, for cooperation in limited areas though, but this is unlikely to have the assertiveness that increasingly characterizes US China policy. The remaining question is whether this modest offer from the EU will be enough for the US and whether the US and China will allow the EU to continue along its current path.

73 The trade ministers of France and the Netherlands made a plea for this form of transatlantic cooperation in February 2020. Riester, F. and Kaag, S. (2021), 'Laten Europa en het Amerika van Biden samen de handel resetten' [Let Europe and Biden's America reset trade together], De Volkskrant, 8 February 2020, https://www.volkskrant.nl/columns-opinie/opinie-laten-europa-en-het-amerika-van-biden-samen-de-handel-resetten~bd677517.
74 Kane, J. (2021), 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)', Institute for Government, 2 February 2021, https://www.instituteforgovernment.org.uk/explainers/trade-cptpp.

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The project aims to explain the differences between the US and Europe's approaches to dealing with the challenges and opportunities posed by China.

https://www.transatlantic-dialogue-on-china.rusi.org

Cover image: A China–Europe freight train loaded with COVID-19 self-testing kits leaves the Haicang railway station in Xiamen, Fujian, on 21 April 2021.
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