



## State of the Union: From Putin's war to a trade war?

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**If she wants the EU to be greener, fairer, and more resilient, Ursula von der Leyen, or whoever comes next, should stay away from trade spats and support a more ambitious industrial policy instead.**

The annual State of the European Union speech (SOTEU), which Commission presidents deliver to the European Parliament in Strasbourg every September, had never been a particularly exciting occasion. That changed in 2020, when the EU was in the midst of a global race to develop and purchase vaccines against Covid-19, and continued through to last year, when the EU was responding to Putin's invasion of Ukraine. From 2020 to 2022, Commission President Ursula von der Leyen's speeches moved away from the technocratic verbiage of years past to grandstanding announcements that often surprised her own officials in Brussels.

With one important exception – the announcement of an investigation into Chinese subsidies for electric vehicles (EVs) – this year's [speech](#) went back to being (relatively) boring. Perhaps the Commission thinks that the crisis is ending and that it can slowly return to its usual, more technical, self. Von der Leyen laid out a range of important but dull policy ideas. But she did not reveal whether she plans to be around to implement them after next year's Parliamentary elections in June. EU capitals and the European institutions alike agree, however, that she will almost certainly win a second term if she runs for it.

It may not be easy to predict von der Leyen's next career move. But it was not hard to [guess](#) the topics she would touch upon in her legacy speech. She has a [strong record](#) on devising the EU's responses to the pandemic and to the war in Ukraine. She came to office promising to steer Europe through the so-called twin digital and green transitions, and she has stood her ground on both, sometimes against the wishes of her own conservative political family and her most important allies.

Those who were looking for cues on von der Leyen's energy and climate agenda for a possible second term might have been disappointed, however. The energy crisis seemed to be almost a memory of the past. Von der Leyen was eager to portray Europe's response to Russia's weaponisation of gas supplies as a success story, without dwelling much on the energy challenges ahead. One topic she was keener to delve into was the thorny political tension between farming activity and nature conservation. By saying

that Europe should find a balance between agriculture and nature conservation, she risked annoying her conservative European People's Party (EPP), which has been campaigning to thwart nature restoration legislation by portraying it as pitted against the interests of farmers across the EU.

But the most noteworthy feature of this year's speech was von der Leyen's shift from geopolitics to geoeconomics. In essence, she tried to answer what will become the EU's most pressing question in coming years: how Europe can cope with increased global tensions and US isolationism. With crucial elections next year in Europe and the US, no end in sight to the war in Ukraine, and mounting Sino-American tensions, it is only rational for the EU to hedge against both populists at home and authoritarian or isolationist forces abroad. One obvious way to do this is to reassure Europeans that their jobs will be safe and the economy strong, regardless of a change of resident in the White House, China's increasingly competitive tech and green industries or Europe's ambitious plans to fight climate change.

That is presumably why von der Leyen chose to frame the EU Green Deal as a growth strategy, and not only an ambitious set of environmental, energy and climate policies. Her new strategy also explains her renewed commitment to protecting European industry from what she considers to be unfair competition, coming mainly from China.

The EU officially [considers](#) China to be "simultaneously ... a partner for co-operation and negotiation, an economic competitor and a systemic rival". That mirrors [differences](#) between EU member-states. The French, for example, have been calling for an investigation into Beijing's subsidies for its electric vehicle manufacturers. Germany, on the other hand, has often opposed the EU taking too assertive an approach to Beijing, out of fear of Chinese retaliation.

Von der Leyen firmly backed the French approach in her speech. The Commission's new anti-subsidy investigation might ultimately lead to the EU imposing additional tariffs on EV imports from China, above the current level of 10 per cent.

Such an investigation carries big risks. The EU has launched vast numbers of anti-subsidy investigations targeting China since 2010, mostly covering much smaller industries like paper, steel, fabrics, optical fibre, tyres and electric bicycles. But few investigations tackled high-value manufactured goods, and none focused on a market as large or as politically important as electric vehicles. This investigation is therefore far more likely to provoke China into retaliation.

There is also no guarantee that the investigation will ultimately justify new tariffs. The Commission will have to identify direct government subsidies targeted at the electric vehicle industry. It must also prove that they cause the threat of material injury to European car-makers: the Commission cannot punish China merely because its car-makers have lower production costs. Proving these things will not be straightforward. Besides, Chinese vehicles are sold domestically at far lower prices than in Europe, so there is little evidence of 'dumping' – this may explain why the Commission chose to launch an anti-subsidy rather than an anti-dumping investigation. It is also unclear how much subsidy (if any) actually distorts competition in Europe as opposed to merely increasing demand in China.

Given these risks, [some](#) believe that that the investigation is merely a ploy to help von der Leyen secure French support for her re-appointment next year. Investigations generally take over a year, so a final decision may end up having to be taken by the next Commission, mitigating the risk of immediate Chinese retaliation until then. But the investigation is not just a sop to the French. While any final

decision will be made after next year's EU elections, the current Commission will still have to publish a provisional decision and decide whether to impose additional tariffs on an interim basis. That provisional decision will need to be made just at the time of the EU elections. If she intends to run, von der Leyen will therefore be under enormous pressure: act tough and risk China retaliating right before the election, which could look like a big misjudgment, or play it safe and look weak.

If the investigation does find that Chinese subsidies have harmed EU industry, the EU's reaction risks misfiring. An anti-subsidy investigation (unlike an anti-dumping investigation) can only apply duties at a country-wide level, rather than singling out individual firms. Yet while the Commission says that 8 per cent of EV sales in Europe are Chinese-made vehicles, overall [about half](#) of China's EV exports are of European and US-owned brands manufactured in China, like Tesla and BMW, and much of the remainder are European and US brands which are now part of Chinese-owned groups. Indigenous Chinese brands are still relatively unpopular in Europe. The new tariffs would be aimed at mitigating the loss of economic activity that would have taken place on European soil but has been unfairly lost due to Chinese subsidies. But they would hurt European and US car firms alongside, and possibly more than, Chinese ones. German firms in particular are more exposed to possible countermeasures because they manufacture much more in China than their French counterparts.

Unlike France, Germany is also a net car exporter, and the investigation would not directly help European manufacturers improve their position when they compete with Chinese manufacturers in third countries. The Commission may end up having to decide whether to hurt the profit margins of American and German car manufacturers for the sake of repatriating jobs.

While Chinese brands' market share in Europe will probably grow in future, the EU also risks overreacting. Most cars are purchased in the region where they were assembled, thanks to the high costs of transporting vehicles long distances, and the tariffs most countries levy on cars. (The EU's high-end vehicles were an exception: their luxury niche meant they could still find willing buyers overseas). There will be temporary anomalies in this pattern as markets incorporate new technologies like electrification: Chinese car-makers have been far quicker to produce EVs than European car-makers. But, as markets mature, it is [likely](#) that gravity will start to reassert itself. And, in the meantime, whacking extra tariffs on cheaper Chinese EVs may simply encourage sluggish European car-makers to keep delaying their own transition to EVs, thus keeping EV prices in Europe relatively high. At any rate, von der Leyen's announcement of the investigation illustrates the increase in global tensions and protectionism: helping a local industry matters more now than making the green transition cheaper for car buyers.

Of course, local industry and the green transition would not need to be in opposition, if the EU were prepared to adopt an EU-wide industrial policy and to [put some money](#) behind it. But had she taken that route instead, von der Leyen would have had to provoke a much bigger fight with Berlin, which is unwilling to set up a 'recovery fund 2.0' dedicated to industrial support, as that would require it to share its budgetary resources with poorer member-states.

The 'European sovereignty fund' – an EU pot which was supposed to help Europe compete with the hundreds of billions of dollars that the US and China are splashing out in subsidies – is now mostly a redirection of existing EU funds. The Commission, wary that richer member-states are unlikely to agree to much new funding, is only asking member-states to chip in another €10 billion in the mid-term review of the EU's 2021-27 budget, which is due to conclude this year. It is not clear member-states will even agree to that relatively small increase. In the meantime, von der Leyen has been managing expectations: the

'sovereignty fund' has been given an ignominiously forgettable new name, the 'Strategic Technologies for Europe Platform', and it barely scored a mention in her speech. Having been blocked by Berlin from announcing more positive support for European industry, the possibility of an investigation justifying higher tariffs against Chinese car-makers may be all von der Leyen could realistically offer.

A more integrated EU industrial policy could deliver better outcomes for European car-makers than higher tariffs would. And it could do so without deliberately breaching international trade law – a red line for Brussels if not for Beijing and Washington. Take France's [recently announced](#) changes to its EV subsidy scheme, for example, which in effect protect European car-makers without overtly breaching international trade rules. Subsidies are only available to 'green' vehicles, and whether a vehicle is 'green' will take into account factors like the emissions involved in transporting it from its place of manufacture, and whether the production facilities were powered by coal or the EU's greener sources of electricity. Under this approach, EVs made in China will struggle to qualify and those made in Europe will qualify for subsidies much more easily. If the EU as a whole applied a similar type of subsidy policy, it might have an equivalent effect to Washington's and Beijing's local content requirements. In practice, China and the US could barely complain about European subsidies disproportionately benefiting European manufacturing, when their own subsidy programs do the same in a more overtly discriminatory way.

After von der Leyen's speech, we do not know whether she will put herself forward for another term, but we have a clearer picture of the ground she will campaign on if she does: a tricky balancing act between ambitious climate goals at a time when Europeans fear that high energy prices and inflation will threaten both the economy and their lifestyle.

Above all, von der Leyen clearly wishes to look tough on China, even if that upsets some of her traditional allies. But if she (and her party) genuinely want a more resilient, green and fair European Union, they should dare to open a tougher conversation with Berlin and other EU capitals who refuse to fund an industrial policy that would both accelerate the green transition and protect the European economy. Otherwise, the EU may have to worry about a trade conflict as much as the military one that so preoccupies it at the moment.

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