

TOWARDS A "PRINCIPLES-FIRST APPROACH" IN EUROPE'S CHINA POLICY

Drawing lessons from the Covid-19 crisis

Edited by

Mikko Huotari | Jan Weidenfeld | Claudia Wessling

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Introduction: Pursuing a principles-first approach in EU China policy

Mikko Huotari and Jan Weidenfeld

KEY FINDINGS

- China's behavior during the Covid-19 crisis has reminded European decision makers and wider publics of their deep interdependence with China and of the resulting vulnerabilities.
- European China policy needs to be grounded in a recognition of China's sustained non-convergence with principles and values that underpin the European project.
- Europe needs to be prepared for all eventualities, including disruption, deterioration and landslide change in the relations with China in the years ahead.
- Europe's economic and political system is in competition with China's strategic priorities. Economic relations with China that continue business as usual threaten to become a liability.
- Effective EU China policy will require swifter and more decisive leadership, and the emergence of ad-hoc coalitions able to advance decisions quickly.

2020 WAS MEANT TO BE A YEAR OF PROGRESS IN EU-CHINA RELATIONS BUT IT ONLY BROUGHT TO THE FORE DISILLUSION

2020 was meant to be the year in which decisive progress was made in EU-China relations. EU institutions and the German government, which assumed the Presidency of the Council of the EU during the second half of the year, had long started preparations for an unprecedented gathering of all EU heads of state and government and their Chinese counterparts on 14 September 2020 in Leipzig. Celebrating the EU-China partnership, EU and China leaders were expected to announce the conclusion of an ambitious bilateral Comprehensive Agreement on Investment (CAI) as well as meaningful commitments to stepping up cooperation on fighting climate change and promoting development and stability in Africa.

The Covid-19 pandemic changed all that. The Leipzig meeting was postponed, CAI negotiations have stalled and China's hardline course in Hong Kong is now putting a heavy strain on relations with Europe. It is unlikely much progress will be made by the end of the year.

To some extent this is just a culmination of trends that have been visible for some time. Disillusionment with China has been growing across Europe for years, as policy makers and negotiators have found it increasingly difficult to find common ground with Chinese counterparts. The last regular annual EU-China Summit between the leaders of the EU institutions and the Chinese leadership in June 2020 ended with zero deliverables: no

agreement was reached on a new EU-China cooperation framework or any other agenda point.

Two other factors underpin the ongoing rethinking of China relations across Europe. First, mounting tensions in the US-China relationship make it increasingly challenging, if not untenable, to maintain an upbeat EU China policy agenda. The deterioration of the relationship between the US and China has led some observers to declare a new “Cold War.” It is, however, more complicated than that, as there will be no revival of a dyadic geopolitical struggle centered on political blocks, military capabilities and alliances. The US-China conflict unfolds under conditions of deep economic, financial and supply chain interdependence and in a world that is unlikely to fall into two neat camps. This makes it much harder for European countries to position themselves.

Second, the Covid-19 pandemic and developments in recent months have exposed the challenging nature of China’s domestic governance and international behavior. This has served as a stark reminder of the vulnerabilities of European politics, business and societies caused by interdependence with China. If there is one key lesson from the Covid-19 crisis to be learnt about China, it is that Beijing’s policies and behavior abroad do not differ fundamentally from its behavior at home. European political decision makers, business and societal actors all face similar difficulties in engaging with representatives of an increasingly authoritarian, politically hardened and globally assertive party state that seeks to exercise control and influence where possible.

Beijing’s policies and behavior abroad do not differ fundamentally from its behavior at home

At the same time, the Covid-19 crisis has clearly served as a wake-up call. These challenges are no longer only apparent to European elites who deal with China on a regular basis; they are now beginning to affect domestic politics and wider European society. From Stockholm to Rome, from Prague to London, China policy is no longer an issue only for top-level decision-making circles; it is now an issue for day-to-day politics across government departments, at all levels of political parties and in regional politics.

BEIJING IS FIRMLY SET ON A “CHINA FIRST” COURSE

China’s behavior during the Covid-19 crisis has reminded European decision makers and wider publics of their deep interdependence with China and of the vulnerabilities that result from this exposure. Beijing’s questionable handling of the crisis at home and its forceful diplomatic offensive abroad, aimed at shaping narratives and engineering loyalty, increased skepticism about the trustworthiness and ambitions of its leaders. The uncertainty caused by the global pandemic will reinforce nationalistic politics not only in the US but also in China, fueling a vicious cycle of distrust, closure and scapegoating, and putting the US-China relationship on a dangerous path.

Going forward, European decision makers can no longer afford to grant China’s party state leaders the benefit of the doubt about eventual convergence with liberal political and economic norms or benign intentions. Nor can they hope to be a bystander or even a beneficiary in the unfolding US-China conflict. European China policy rethinking needs to be grounded in a realistic assessment of China’s current trajectory: leaders in Beijing are pursuing a “China first” mission that can be summarized as making China’s rise inevitable, resistance futile and collaboration profitable. More specifically, Beijing’s global “China first” trajectory is likely to be characterized by four features.

First, China is doubling down on strengthening party and state capacity. President Xi Jinping has overseen a massive concentration of power in the CCP top leadership, focusing heavily on the renewal of party cadre loyalty and aggressive punishment under the guise of an anti-corruption campaign. During the summer of 2020, internal politics hardened further, with a purge in the security apparatus and a “political-legal rectification” campaign to support Xi’s grip on power.

With ideological conformity as a primary goal, Beijing has also dramatically expanded control over the internet, media and civil society and is introducing state-of-the-art surveillance technology. As a result, the system is geared more than ever to suppressing dissenting voices and to disseminating the CCP’s populist narrative of a renewed China that is returning to its former greatness. However, with the centralization of power, the CCP has also become more prone to displaying mistakes, weaknesses and vulnerability. Failures of control, such as CCP document leaks over detention camps in Xinjiang, or Beijing’s initially indecisive response in 2019 to public unrest in Hong Kong have hinted at persistent defects in China’s political system. Insecurities and power struggles among Chinese governing elites have created a domestic and global outlook defined by paranoia, which lends itself to a permanent mindset of friend-foe distinction.

Insecurities and power struggles have created a mindset of friend-foe distinction

Second, China is increasingly confident about approaching global affairs based on just such a clear friend-foe distinction, which often puts it at odds with the interests and actions of OECD countries. CCP elites have come to identify “global governance” as an area of persistent struggle in their desire to carve out a more visible and fitting role for China. As with domestic governance, China rejects the liberal norms underpinning existing global rules and multilateralism. These include the universality of human rights and some of the building blocks of international law. China is also establishing elements of a “parallel order,” bolstering bilateralism at the expense of multilateralism. Where Western powers pursue a multi-stakeholder approach, China promotes state-centric norms. Beijing has only partially modified its approach when faced with pressure, largely shrugging off criticism for non-compliance with WTO principles or of the Belt & Road Initiative’s (BRI) questionable approach to financial, environmental and social sustainability. Instead, Beijing is contemplating options for transforming BRI countries into a China-centered club of less-advanced economies, providing an alternative to stringent WTO rules and OECD association.

Third, economic policy making in China will continue to put a high premium on strategically managing China’s global economic interdependences. The economic outfall of the Covid-19 pandemic has put China’s economy and companies under considerable pressure. In response to external and internal pressure, Xi is promoting a new theory of “dual circulation” meant to propel China’s development and competitiveness, protect China from outside shocks and support his techno-nationalist visions. As a result, China is likely to see elements of “war time style economic policy,” offering little room for urgently needed structural reforms and meaningful opening to foreign competition.

Rather, China’s economic policy will continue in its neo-mercantilist fashion, focusing on crisis management, central party leadership and control, upgrading of the state sector, doubling-down on autonomous innovation and continued attempts to localize high-tech value chains. US-China economic competition will only accelerate China’s existing drive for technological self-sufficiency and bolstering the autonomy of its indigenous innovation capacity, while the uneven distribution of credit, over-investment in government-pri-

ority sectors, the ubiquitous nature of non-tariff barriers and discriminatory standardization policies will continue to present formidable challenges for European companies.

Fourth, and very visible during this crisis, leaders in Beijing are defining China's global role as a peer competitor to the US. Other relationships are seen first and foremost through that prism as well. From a Chinese perspective, competition and conflict with the US will play out in all relevant geographic and functional arenas, including in Europe. Accordingly, a stable but indecisive Europe would be a convenient economic partner and helpful counterbalance to the US, while a strong and self-interest driven Europe that acts in a way that is aligned with like-minded partners would not be in China's interest.

European China policy needs to be grounded in a sober recognition of China's frequent and sustained non-convergence with principles, values and best practices that underpin the European project and liberal-democratic market economies in the OECD world. Leaders in Beijing are no longer content with just preventing such principles and values from taking root in China; they are also seeking to push back on these internationally. Europe will therefore have to accept what CCP leaders have long concluded internally: Europe's system of economic and political governance is in competition with China's strategic priorities and political preferences.

PURSuing EUROPEAN INTERESTS WILL REQUIRE A RECALIBRATION OF EU-CHINA RELATIONS

While China is set on a course that is challenging to Europe, it is also in many respects key to meeting EU ambitions. To create the competitive, green, digital, sovereign and more geopolitical Europe that the current European Commission has pledged to accomplish, the EU institutions and member states will need to make China policy and relations with China a success. This is particularly true with a view to:

- (1) Establishing Europe as a third actor in global digital competition next to the US and China;
- (2) Integrating China in a global green deal;
- (3) Developing a firm position in unfolding US-China strategic competition; and
- (4) Tackling China's growing influence in geographies of interest to Europe.

Against this backdrop, economic relations with China that continue business as usual threaten to become a liability for Europe. Lack of progress on negotiated bilateral agreements with Beijing as well as China's patchy compliance with existing multilateral rules with regard to greater market access (CAI), fairer competition ("competitive neutrality") and the future of rules-based trade (WTO reform), create long-term challenges to European competitiveness and economic security. Commercial opportunities no longer outweigh the growing political and strategic disagreements and challenges in Europe-China relations.

The uncertainties associated with the unfolding trade, tech, financial and societal decoupling between China and the US and the potential costs of just "muddling through" are a case in point. Often grounded in a desire to avoid putting economic relations with China in jeopardy, European politicians can no longer get away with postponing major strategic decisions, such as on the role that Chinese companies should have in building critical European infrastructure like 5G networks or energy infrastructure, or the extent to which European companies and research institutes should engage in research, development and

Economic relations with China that continue business as usual threaten to become a liability for Europe

innovation cooperation with China. Whether intended or not, taking decisions on issues like these will position Europe in the unfolding US-China strategic competition and have potentially severe ramifications on European relations with both sides.

What was largely seen as the automaticity of a mutually beneficial deepening of economic relations between the EU and China is now not only questioned but overshadowed by a growing list of contentious issues. Europe cannot ignore the abolition of the “one country, two systems” approach in Hong Kong and the systematic human rights violations in Xinjiang. As European public scrutiny of China and its actions grows, European leaders can no longer content themselves with facilitating business dealings between European and Chinese companies. They have to publicly position themselves in relation to Beijing’s assertive behavior in the South China Sea and towards Europe’s partners, like Australia, Canada, Japan, India or Taiwan, and to respond to the more open attempts of Chinese actors to influence European politics.

China also poses growing challenges to European security and sovereignty. China is not only leaving a security footprint in geographies closer to Europe such as in Serbia, Belarus, or the Middle East but also becoming a leading player in the cyber and space domain. Beijing’s alignment with Russia, including in the UN security council, shapes the global security architecture as does China’s military build-up and its seemingly soft-security cooperation with an expanding network of partners. China challenges Europe’s strategic autonomy with disinformation and political dealignment. Its actions have the potential to undermine economic security and the development of a sustainable (defense) industrial base, secure supply chains and European digital sovereignty. Most fundamentally, China is already a major point of contention in the transatlantic relationship, which is still seen by many EU member states as the bedrock of European security.

It is time for Europe to rise to the challenge and shape more decisively what is going to be one of its most consequential relationships in the 21st century. To do so, principles and power matter more than lofty notions of a diplomatic partnership with China (see Box 1).

A PRINCIPLES-FIRST APPROACH SHOULD HELP STRUCTURE EUROPEAN CHINA POLICY AROUND FOUR LOGICS OF ACTION

Competition should be the default when engaging China

Future European strategies and policies towards China should be defined by China’s actual conduct, behavior and normative impact, rather than vague hopes for change in China, Chinese alignment with OECD norms, and mutually productive cooperation between China and Europe as a default outcome. In forging a new relationship with China, it is neither in Europe’s interest to tolerate Beijing’s vision of co-existence on primarily Chinese terms nor to pursue a policy aimed at equidistance between authoritarian China and, what has lately seemed all too often, a flawed US liberal democracy. Full-fledged decoupling and an all-in alignment with hawkish US policies towards China is not in Europe’s interest, but abandoning efforts to revive transatlantic cooperation is certainly even less sensible.

Taking the March 2019 “EU-China: A Strategic Outlook” Communication of the European Commission and the HR/VP to the European Council as a basis for thinking about the future shape of EU China policy, it becomes clear that such policy should be rooted in a principles-first approach, with competition as the default when engaging China. This does

not imply a singular approach but the bundling of different types of strategic action that are essentially geared at meeting three goals, namely improving **(1)** Europe’s resilience, **(2)** its comprehensive competitiveness and **(3)** Europe’s global relevance, including vis-à-vis China. Such an approach still leaves room for targeted cooperation with China where this serves European interests and strategic goals. It neither excludes forceful push-back and the formation of counter-China alliances, nor the possibility of negotiated improvements in the relationship with China if these shift the trajectory towards fair(er) competition

Box 1

Europe’s strategy vis-à-vis China needs to translate shared assessments into decisive and joint action



A steadily growing list of European governments have managed to conduct thorough internal reflection processes on China policy, with new across government coordination mechanisms and sometimes also publicized strategies as a result. Dialogues with key European partners, including in the NATO framework, have also put China strategizing on a new level. Dozens of seasoned European parliamentarians as well as wider political parties across Europe are discussing much more intensely internally and with partners the future of national and European China policies. In carving out new China strategies and policies, EU governments can also increasingly count on key stakeholders at home. Policy papers by business associations, including Business Europe, the BDI, VDMA or Confindustria acknowledge the need to “address the systemic challenge” China poses and to “rebalance the relationship with China.”

In charting a new course, European governments can build on a series of successful strategic actions pursued over the past few years at joint EU-level. Brussels has acted swiftly on important policies related to China, gearing up its agenda-setting abilities and institutional structures. The EU has adopted new assessment methods for China’s dumping practices in 2016 that averted China gaining inappropriate “Market Economy Status” (MES), and it has introduced an EU-wide investment screening mechanism to come into force in late 2020, also prompted by the PRC’s “Made in China 2025” industrial policy. It is in the process of rolling out its own connectivity strategy and bolstering industrial and innovation capacity and competition and procurement policy. Dealing with concerns about China’s Huawei, the EU’s 5G security review is

unparalleled in terms of processes and could provide a blueprint for future similar exercises.

Akin to attempts in many EU member state capitals to coordinate better on China policy across government departments and agencies, the Brussels machinery is also stepping up its game. China was on the EU Council agenda for the first time in 2019 and EU leaders have agreed the relationship with Beijing must be discussed more frequently and consistently at the EU’s highest level. China has also become more visible on the agenda of the EU’s Committee of Permanent Representatives and the Political and Security Committee, and many Commission cabinets have prioritized China work. To streamline policy discussions, a China strategy group has been set up within the Commission headed by the Secretary-General.

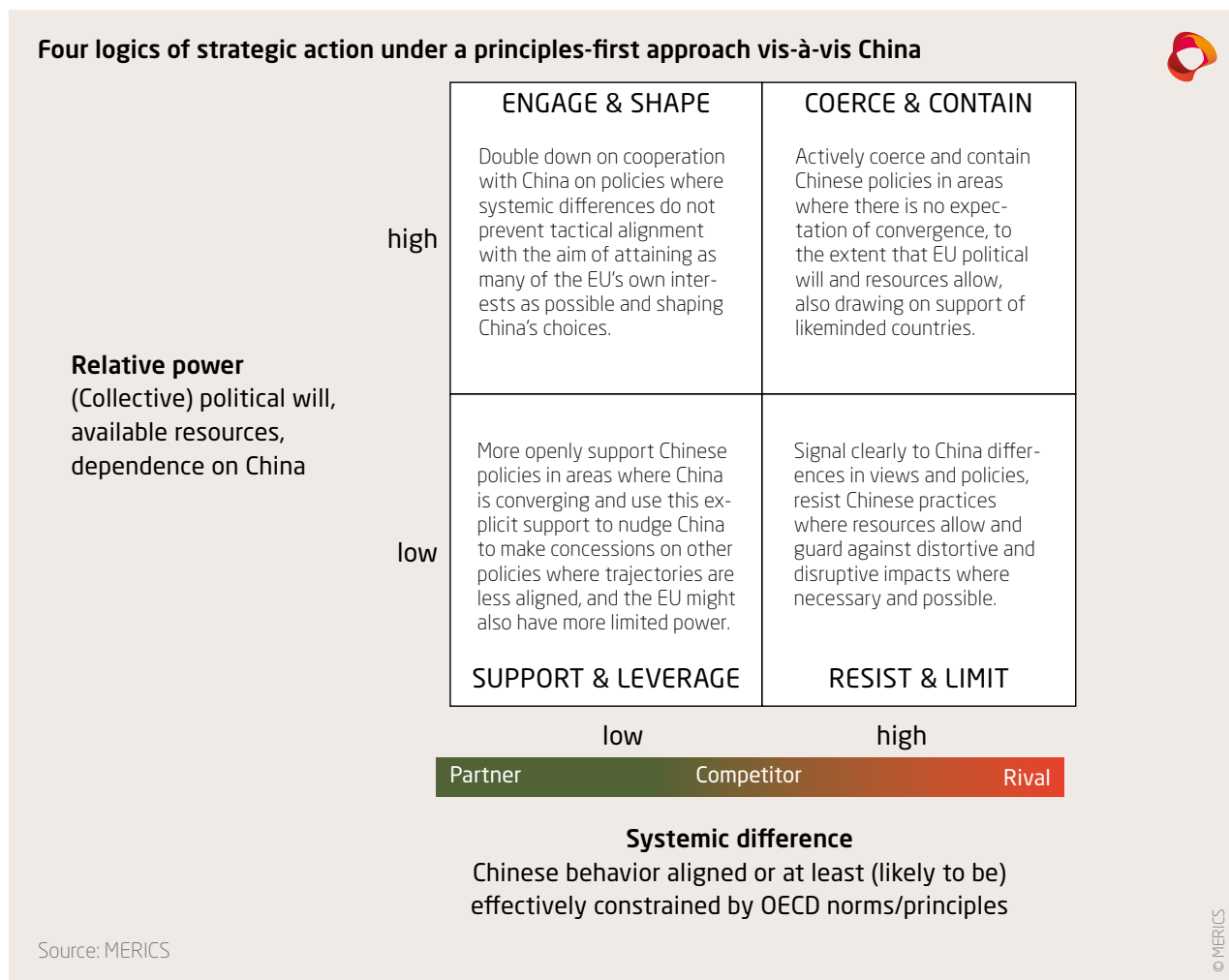
Brussels’s activism around China has borne some fruits in forging greater EU unity when it comes to assessing China and its trajectory. The March 2019 “EU-China: A Strategic Outlook” Communication of the European Commission and the HR/VP to the European Council has become a critical point of reference for EU member state policy making on China. For the first time, the strategic outlook established an agreed set of EU ways to think and talk about China, namely as a partner, a competitor and/or a systemic rival. This has done away with a widespread assumption of a gradual and ultimately inevitable deepening of the EU-China (strategic) partnership and cast a light on the fact that China is set to double down on policies that would give rise to competition if not outright rivalry with Europe.

from a European perspective. Europeans should continue to expect and demand upward convergence from China in areas where interests align and fundamental differences matter less.

Overall, however, when calibrating actions on critical policy issues, the EU and its member states should take into consideration the extent of systemic differences with China and their own relative power. In a first step, the EU must sharpen and systematize the application of its current framework of assessment of China as a partner, competitor, or systemic rival. In short-term policy choices, this might simply require assessing where there is superficial alignment in EU and Chinese interests which might provide space for tactical cooperation.

In a more strategic calibration of longer-term action, the EU should consider the extent to which China’s behavior and policy choices are aligned with (or at least constrained by) OECD political norms and economic principles. This includes first and foremost a commitment to pluralist democracy based on the rule of law and the respect of human rights, adherence to open and transparent market economy principles, boundaries for state interference and a shared goal of sustainable development.

Exhibit 1



As a second step, the EU will have to conduct realistic assessments of its relative power in pertinent policy domains and vis-à-vis China. Relative power is primarily a function of

- (1) how much (collective) political will the EU is able to mount,
- (2) the resources available to pursue its interests (alone or with partners) and
- (3) the EU's dependence on China and ability to bear the costs of non-conformity with China's expectations.

Weighing these factors, the EU can pursue four principal courses of action towards China, as set out in Exhibit 1.

ITS CHINA POLICY SHOULD HELP THE EU STRENGTHEN RESILIENCE, PROMOTE COMPETITIVE LIBERALISM AND ATTAIN GREATER GLOBAL INFLUENCE

As the remaining chapters in this MERICS Paper on China set out in greater detail, in the years ahead, EU China policy will have to aim first and foremost at strengthening European resilience, promoting competitive liberalism at home and abroad and generating greater global influence, including by working together with like-minded partners on matters regarding China. Often this will require the EU and its member states to combine defensive and offensive measures in their China policies and, in some cases, this might even require managing a partial disengagement from China.

RESILIENCE

A successful China policy starts at home. More societal debate and discussion about the right path forward should be welcomed as these create awareness and a political sense of urgency. They also ground China policy in some of the most important sources of European resilience toward China: openness, transparency and adaptive democratic consensus.

**A successful
China policy
starts at home**

- To protect the EU's political sovereignty and unity, decision makers need to contain China's attempts to coopt elites and swing European and public sentiments in favor of authoritarian approaches to governance. This will require first and foremost investments in transparency and openness. Independent European knowledge production industries are indispensable to counter China's promotion of its strategic narratives and disinformation activities. European governments also need to promote stronger rules around transparency, disclosure and revolving doors in countering Beijing's cultivation of elites. To tackle pressure for self-censorship, the EU and its member states need to facilitate information-sharing and learning from like-minded affected partners.
- To pursue safe interdependence with China, European decision makers in business and politics need to face up to long-term competitive risks, immediate vulnerabilities and the potential for exploitation of economic dependencies for political gains. They must be smart and selective about how they choose to reduce exposure to China. That will require objective decision-making on the costs and benefits of such moves. Europe should adopt a more systematic approach and recalibrate interdependence in a way that addresses European vulnerabilities while building on its strengths. Based on

EU-level and national-level reviews of strategic industries and specific goods that are critical to national security, the EU should limit its exposure to China through a strategy that prioritizes diversification – and in some cases relocation – of critical supply chains. To pursue a security-conscious approach to managing evolving interdependencies with China in emerging technology ecosystems, economic policies will have to be fused more systematically with EU and member state security policies. This will also require innovation and technology policies that prioritize deepening relationships with like-minded partners. New institutional mechanisms fulfilling the functions of an “economic security council” would enable member states and the EU to devise forward looking policy responses at the nexus of technology, trade and security.

COMPETITIVE LIBERALISM

Brussels’ current focus on reciprocity and fairer competition in Europe’s China relationship is right but European competitiveness in a more encompassing sense is at stake. As it remains unrealistic for the EU and member states alone to alter China’s trajectory, they will have to compete fiercely to make their own interactions with China and the world safer for liberal-democratic market economies – big and small.

Brussels’ focus on reciprocity and fairer competition is right but European competitiveness in a more encompassing sense is at stake

- To compete (with China) in the digital age, with the US-China tech conflict heating up, decision makers will face increased pressure to think even more strategically across policy domains and competences. The challenge is to translate industrial and digital strategies into action and to overcome longstanding weaknesses in terms of digital market fragmentation, regulatory hurdles and underinvestment in scalable tech businesses. When it comes to research and innovation with China, a risk-based approach is needed to prevent unwanted tech transfers. On standardization, EU actors need to coordinate their lobbying efforts in China, especially in the context of China Standards 2035. Brussels and member states should insist on digital reciprocity as a new principle in bilateral relations. In navigating China’s emerging data regulations, the EU should monitor competition distortions arising from unequal access to data in the Chinese market. The EU will need to join forces with partners around the world to confront Chinese challenges from forced technology transfers to digital protectionism.
- To advance liberal multilateralism globally, the overarching logic of European responses and initiatives toward China must be significantly more competitive, accepting the systemic rivalry that China’s leaders take for granted. China’s selective adherence to essential international obligations puts into question Beijing’s trustworthiness as a partner more broadly. Beijing’s current trade policy profile does not lend itself to joint rulemaking. On human rights, concrete measures will have to move beyond the failed quiet diplomacy approach of the past. As a major donor and actor in the development sphere, the EU should make more strategic use of its capacities to engage China to promote greater transparency and sustainability. In the digital arena, there are still a few opportunities to shape China’s approach to improving data security and facilitating cross-border data flows. These issues constitute an integral and interlocking system of liberal multilateralism. Non-action or silence on one of them will damage Europe’s long-term capacity to compete and deliver in adjacent arenas.

GLOBAL PRESENCE AND POWER PROJECTION

European China policy will succeed or fail on the global stage, too. Europe's action on China needs to factor in that countries and institutions across the globe are equally affected by China's behavior, conduct and normative impact as well as the resulting global strategic landscape. In theory, this creates massive new opportunities for developing and deepening Europe's global partnerships to create leverage and alternative alignments beyond the US-China conflict. In practice, Europe will face a series of critical China-tests in advancing the effective provision of global public goods and in prevailing in geopolitical contestation in arenas of European interest.

European China policy will succeed or fail on the global stage, too

- To make progress on urgent global health and climate issues, the EU will have to pursue more conditional cooperation in order to engage China and shape its behavior, while competing in delivering these global public goods with the aim of creating pressure for upward convergence. EU engagement with China on climate change discussions might have to be made contingent on other issues China deems important, including trade, science and technology cooperation, investment and finance. The EU should enlist global partners for bolder standards regarding international energy projects and green finance. The connectivity strategy and its commitments to “sustainable” connectivity remains the single best framework for pushing China toward higher standards and supporting EU firms that abide by these too. On global health, the EU must act more often as a counterweight – member states should use their financial and diplomatic weight to push through much needed reforms within the WHO. China's Health Silk Road presents the EU with multiple new policy challenges. On the one hand, the EU should unite with like-minded countries to push back against Beijing's Covid-19 propaganda and disinformation campaigns. On the other hand, the EU should continue to actively engage and cooperate with China on targeted global health projects and research.
- China's actions in the Western Balkans, the MENA region, the Indo-Pacific and “new geographies” of geopolitical competition, like the Arctic, are among the most pressing geopolitical challenges the EU currently faces. These call for both containment and also guarded cooperation in specific cases. To contain China's actions in the Western Balkans the EU must provide a more credible path to EU accession for countries in the region and more actively promote access to EU investment and financing sources. The EU should also support relevant actors in the Western Balkans to adequately assess Chinese loans and investments before they are accepted. Where China's investments and projects align with EU norms and standards, cooperation should be considered. This might apply in particular for the MENA region. Limiting and resisting China's behavior in the Indo-Pacific will require, first and foremost, cooperation with like-minded states. This should not be limited to the United States but also include other countries in the region whose values and interests in this space converge with the EU's, such as Japan, Australia, South Korea, Taiwan, India, or Vietnam. With a view to China's evolving role in the Arctic, EU member states should urgently establish close coordination and possibly even a working group that can help to coordinate EU measures aimed at containing China's role, where necessary.

For the EU to succeed in the pursuance of greater resilience with regard to China, the promotion of competitive liberalism at home and abroad and the development of new global partnerships will require doubling down on key principles of domestic governance that have underpinned and accompanied European integration in the past. That means strengthening transparency and rule of law and defending robust openness and fair com-

petition. In developing China policy, Europe would be ill advised to copy China, restrict societal engagement with China, or engage in more state dirigisme and protectionism.

The EU must continue to find common ground with the US

The EU must also continue to find common ground with the US when it comes to the formulation of future China policies – be it from November onwards or in four years' time. Such efforts should revolve around agreeing on mechanisms for damage control and avoiding greater dealignment as a baseline. A more ambitious transatlantic agenda could build on recent moves towards a transatlantic trade rapprochement, with the formation of a transatlantic trade and technology council as a key institutional building block for facilitating transatlantic conversations and cooperation on critical China challenges. EU member states and the US should also aim to further deepen security and intelligence partnerships, which would allow them to prepare more effectively for future security escalations in relation to China.

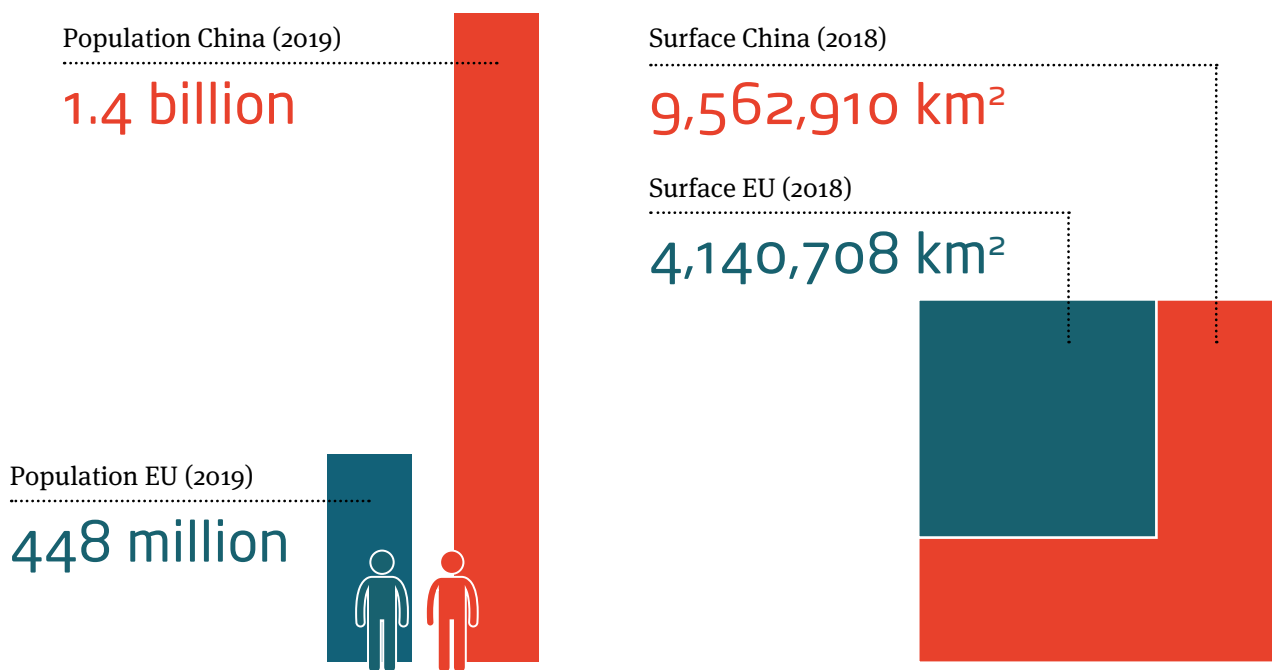
Ensuring that the trajectory of EU-China relations meets with European interests, the EU will also have to change its inner workings and embrace a greater degree of pragmatism than has been the case in the past. It is rather telling that the latest EU-China summit in June was considered a success in Brussels, if not because of the nature of interactions with China but because of the relative unity the EU displayed vis-à-vis China. The fact that the EU assertively conveyed to China its positions and expectations on a full range of issues is indeed no mean feat, given that creating alignment on China matters in Brussels and across the EU remains challenging business.

Conveying largely aligned messages will not be enough. Ultimately, better China policy is probably one of the most important reasons for a reform of the way foreign policy is done in the EU, with stronger elements of majority decision-making. However, effective EU China policy will require swifter and more decisive leadership, and the emergence of ad-hoc coalitions able to advance and coordinate decisions quickly. This will require EU member states and EU institutions to have all relevant government and institutional players adopt and embrace a joint perspective on China which is rooted in a principles-first approach, centered on competition.

Developing China policy rarely leaves time for long reflection or extensive assessment, as policies are often outdated by the time they appear. Indeed, EU China policy will in many respects have to be provisional by default, as constant adaptation and changes in relation to developments in China and emanating from China will be required. Europe needs to be prepared for all eventualities, including disruption, deterioration and landslide change in the relations with China in the years ahead. Finding a response to these eventualities will require flexibility without compromising on European interests and principles.

BASIC FACTS

Despite the fundamental differences between their political systems, the EU, its member states and China entertain close relations on different levels of politics, the economy and society.



Source: World Bank



GDP current prices EU (2019)
USD trillion 15,593

GDP per capita EU (2019)
USD 34,843



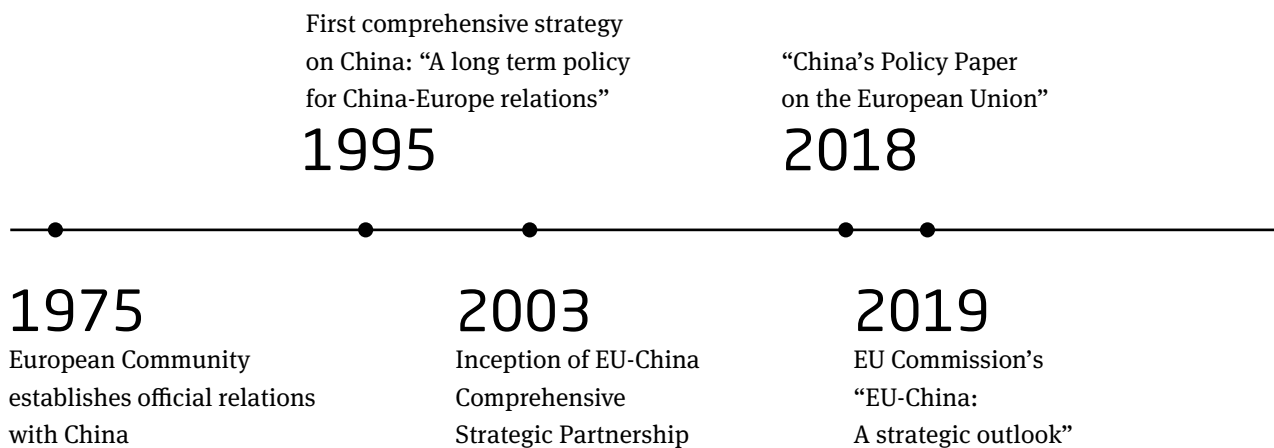
GDP current prices China (2019)
USD trillion 14,343

GDP per capita China (2019)
USD 10,262



Source: World Bank

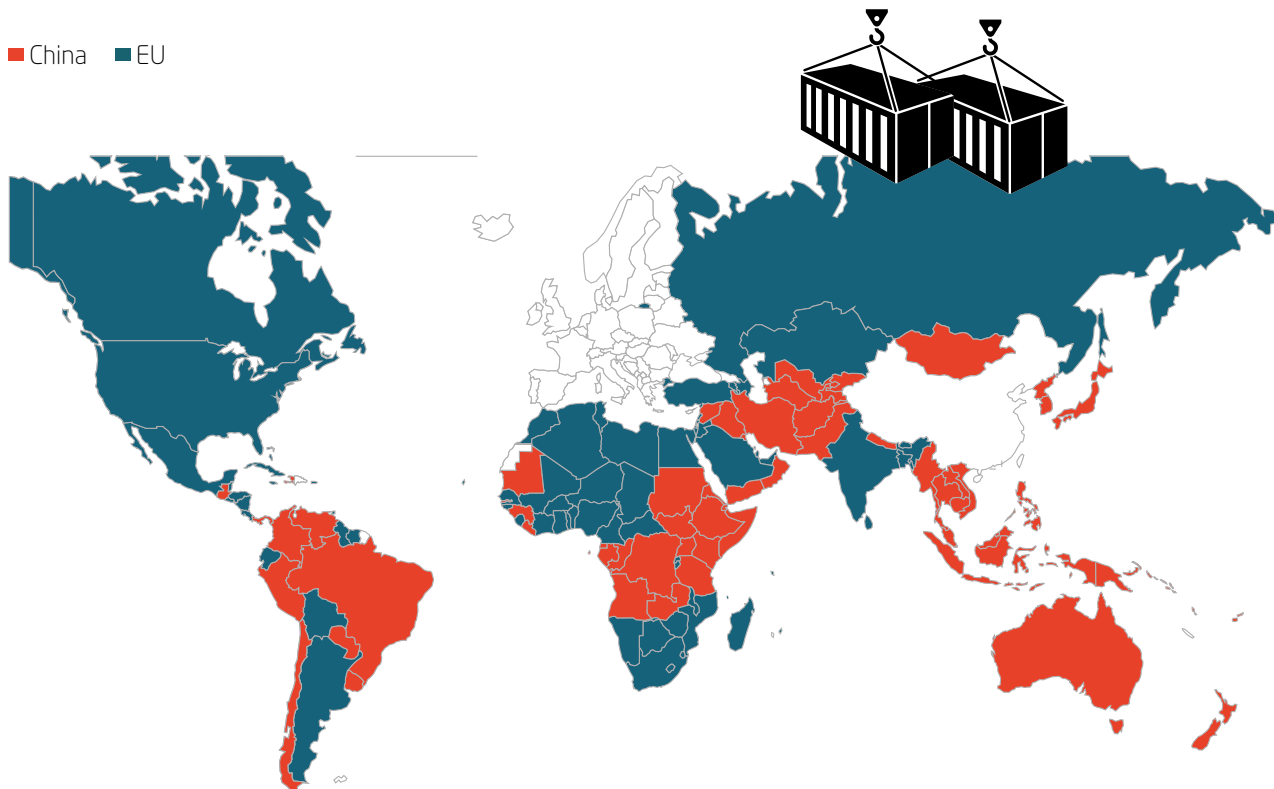
Key events in EU-China relations



China is catching up with Europe to compete in global trade

Larger share of a country's total trade with China and the EU in 2018

■ China ■ EU



Source: Comtrade

Note: Only selected countries are displayed in this map.

ECONOMIC INTERDEPENDENCE

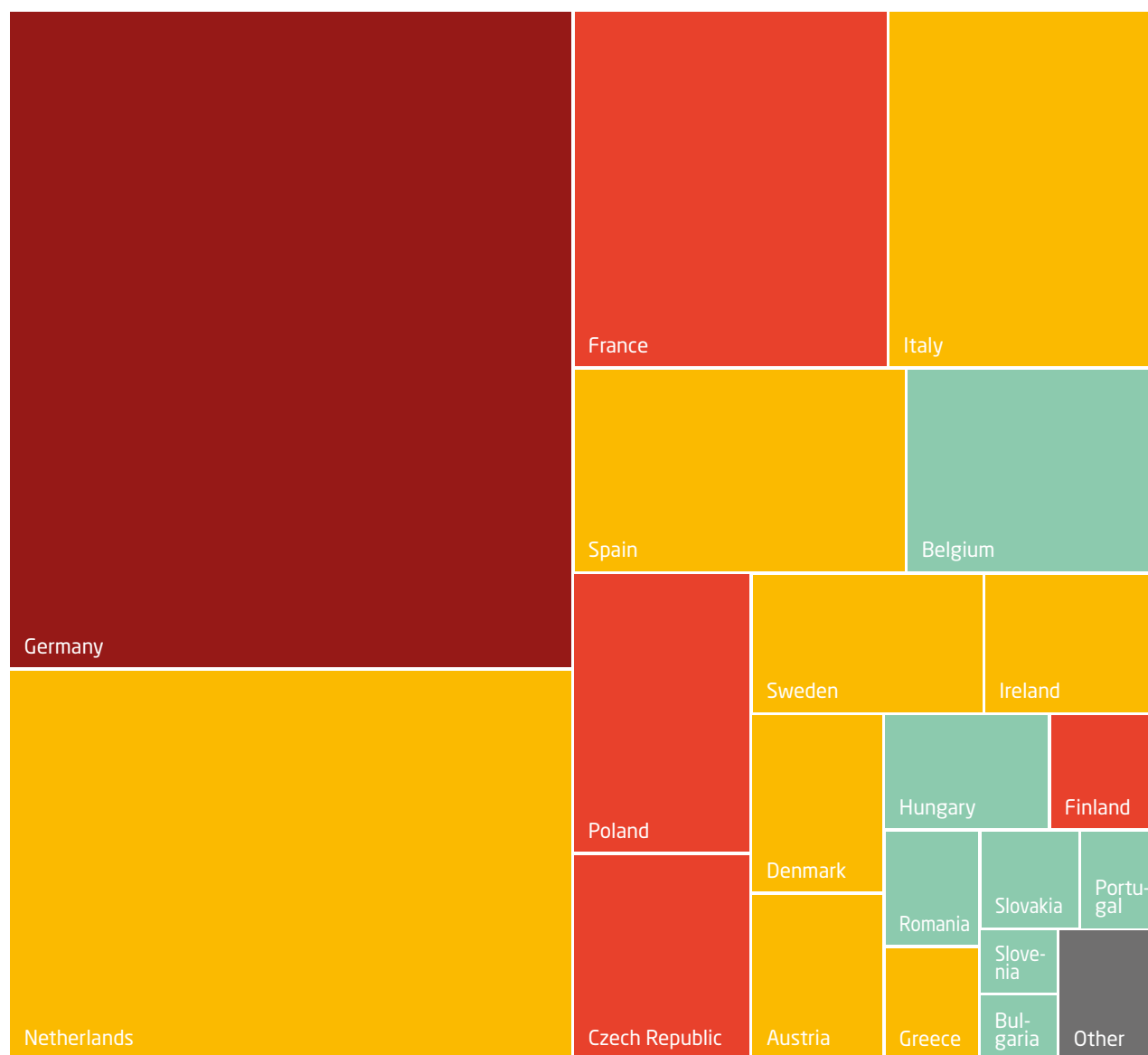
The EU is China’s number one trading partner but individual member states usually trade most with their European neighbors and export significantly more to the US than to China.

What China sees in Europe as a trading partner

Size: EU member states’ share of EU-China trade (2018)

Color: China share in member state total trade (2018)

■ 2-4% ■ 4-6% ■ 6-8% ■ >8%

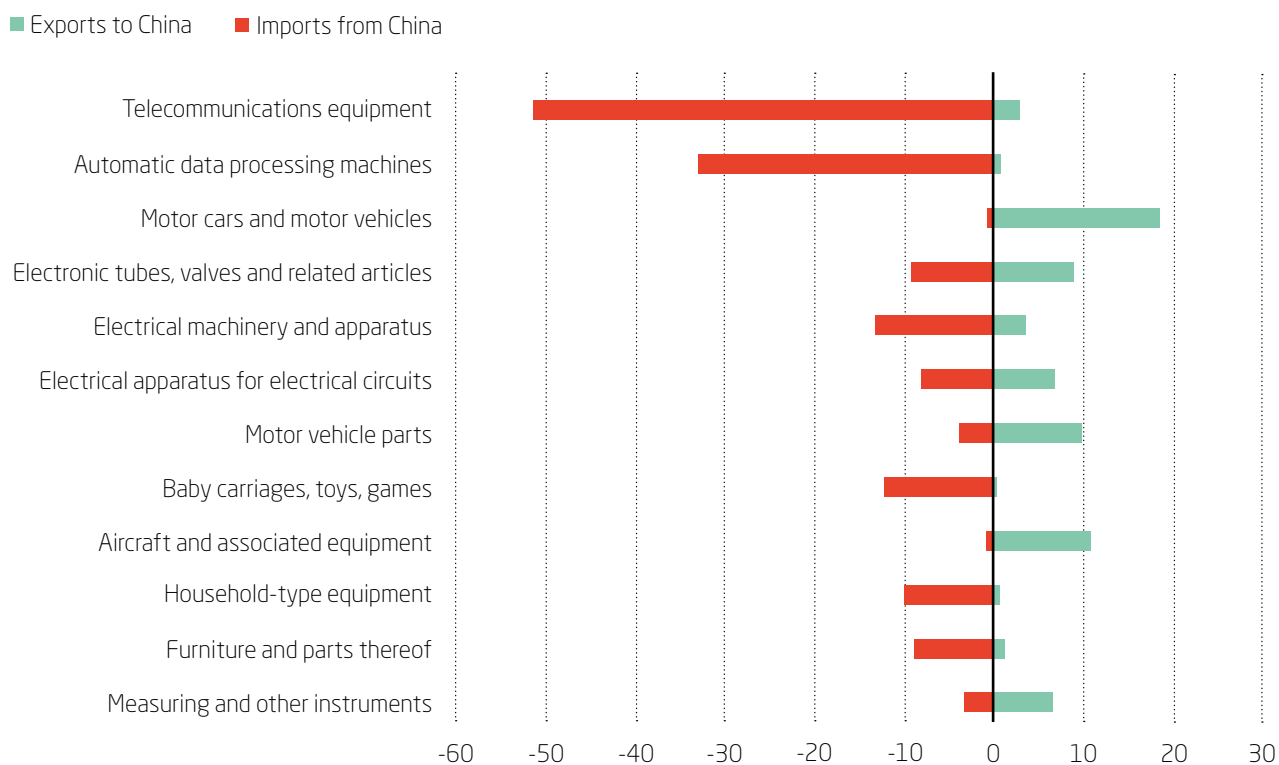


Source: Comtrade

Note: Trade data for the Netherlands is often distorted by transshipment.

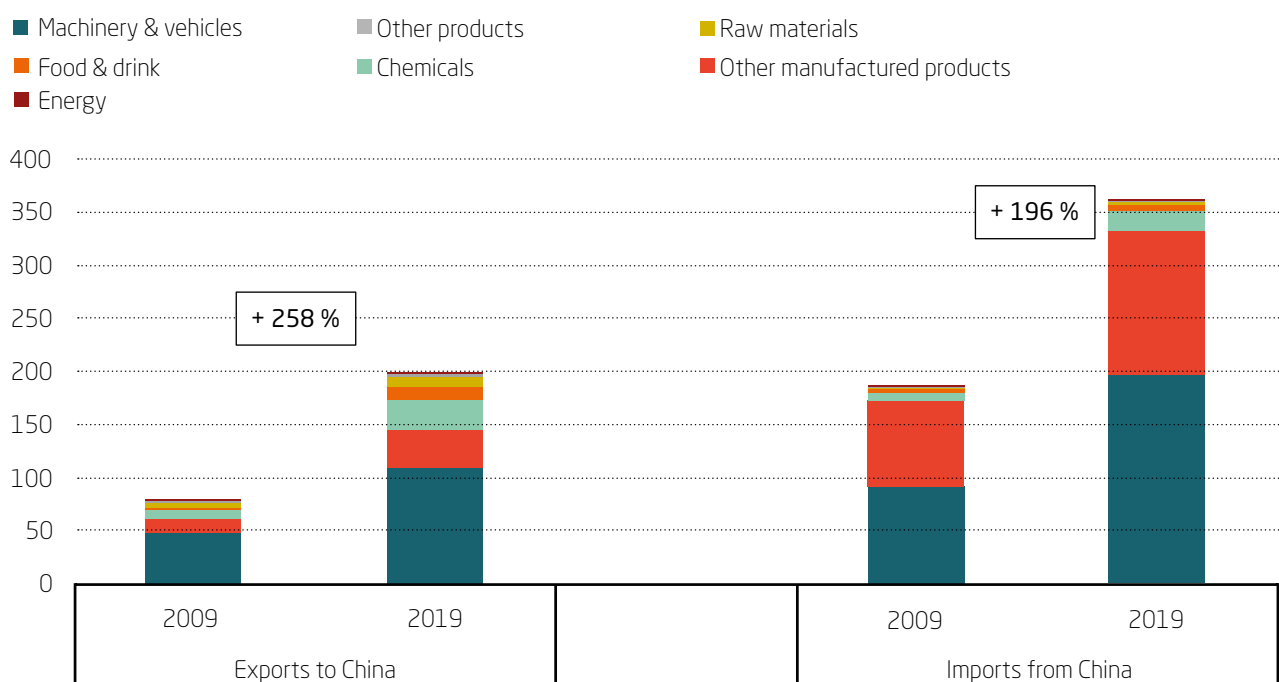
Exchanging phones and computers for cars and machinery

Top 12 most traded products between EU-27 and China, 2019 (EUR billion)



Exports to China have been growing faster than imports over the past decade

EU-27 trade with China by product group, 2009 and 2019 (EUR billion)

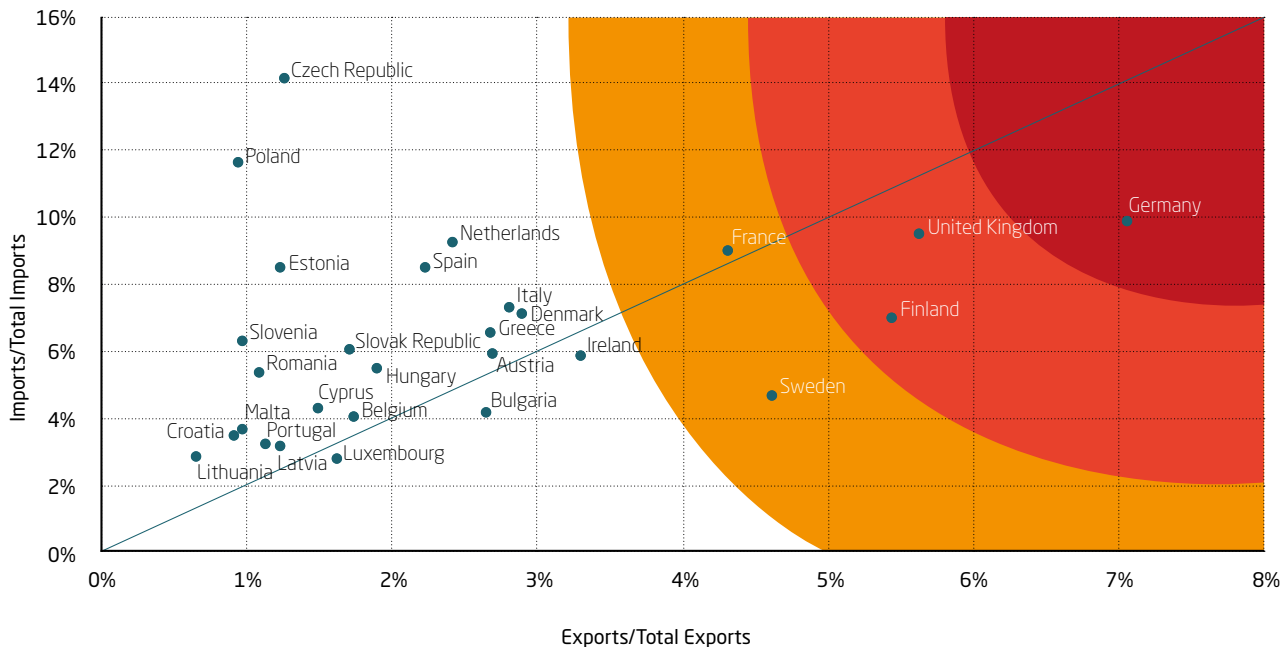


Source: Eurostat

ECONOMIC INTERDEPENDENCE

European trade relations with China differ substantially

China share of total imports (y-axis) and exports (x-axis) (2018)



Source: Comtrade

EU's import dependence for critical inputs is concentrated in chemicals and electrics

Selection of non-consumer goods with strategic import dependence (2019)

Product	Import share from China	China global market share	EU trade balance with the world (in USD million)
Heterocyclic compounds <i>(used in pharmaceuticals)</i>	89 %	76 %	-11
Personal protective equipment (PPE) <i>(e.g. protective clothing, masks and gloves)</i>	68 %	62 %	-1,819
Manganese <i>(used in electric vehicle batteries)</i>	83 %	75 %	-231
Rare earth metals <i>(used in high-tech products like smartphones)</i>	81 %	40 %	-10
Printed circuit boards <i>(used in most electronic products)</i>	63 %	57 %	-4,147
Digital processing units or optical readers <i>(used in audio and image processing)</i>	60 %	47 %	-6,614
Molds for plastic or rubber injection <i>(used in manufacturing of parts & components)</i>	64 %	33 %	-501

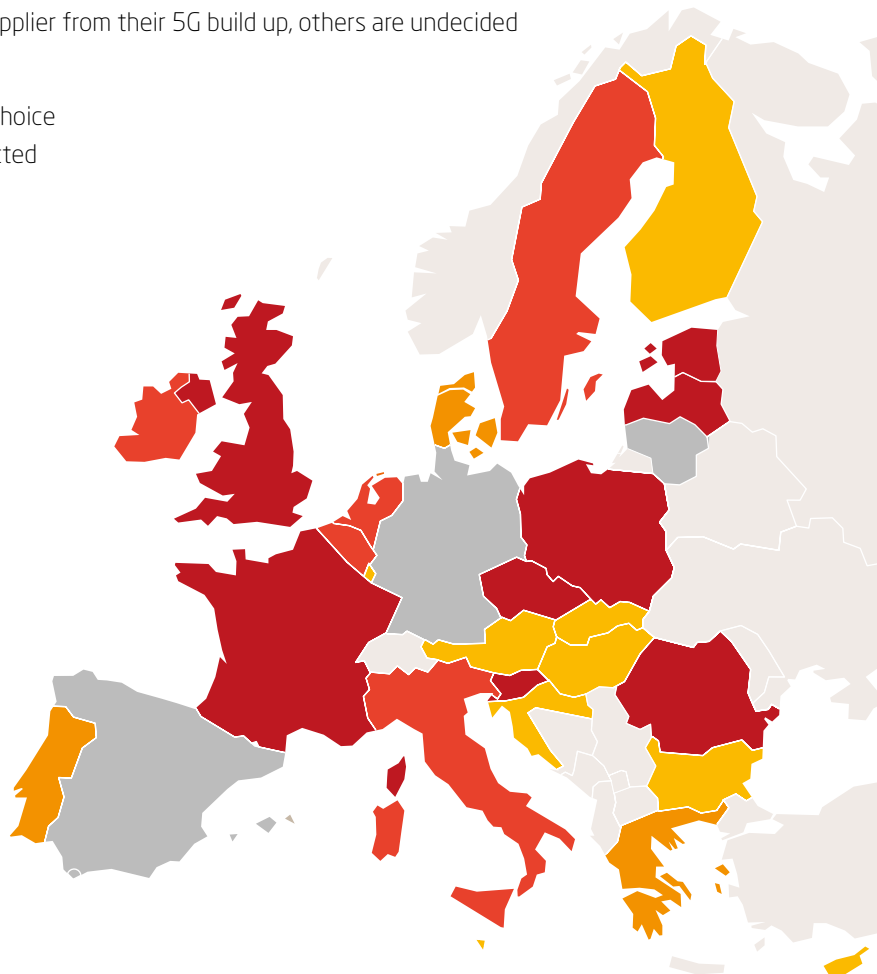
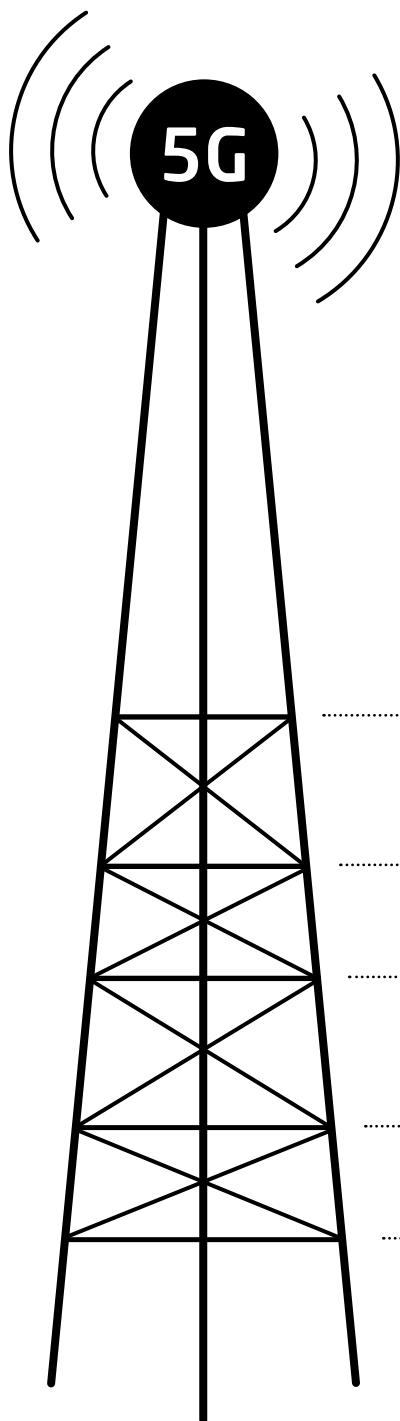
Source: Comtrade

RISKY INTERCONNECTEDNESS

2020 is a decisive year for Huawei in the EU*

Some countries have excluded the supplier from their 5G build up, others are undecided

- No restrictions in place or expected
- Partial restrictions due to carriers' choice
- Partial restrictions in place or expected
- Huawei being de-facto excluded
- Undecided



June 2020: Denmark's defence minister says that the government wants to exclude suppliers from countries not considered security allies, though an official decision has not been made yet.

July 2020: The UK government excludes Huawei from its 5G networks, ordering the total removal of its gear by 2027.

July 2020: France tells telecom operators that their licenses for Huawei gear will not be renewed once they expire, which implies a de facto phase-out by 2028.

August 2020: A new draft legislation would effectively exclude Huawei from Romania's 5G networks.

August 2020: Slovenia signs a joint statement on 5G cooperation and security with the US. Romania, Poland, Estonia, Latvia and the Czech Republic have all signed similar declarations.

Source: MERICS

Note: Timeline includes selected events, UK still considered EU member state (transition period still ongoing)

CHALLENGES AHEAD



1. How can the EU deal with Chinese influencing?
2. What does the growing economic entanglement with China mean for European businesses?
3. What do China's ambitious strategies for self-reliance and innovation mean for technological and research cooperation?
4. How can the EU deal with China's instrumental approach to multilateralism and its selective disregard for existing treaty obligations?
5. From climate to health policy: what are areas of collaboration?
6. How should the EU position itself in the US-China conflict?



1. Protecting the EU's political sovereignty and unity

Lucrezia Poggetti

KEY FINDINGS

- Beijing's behavior during the coronavirus pandemic has confirmed for many that the Chinese party-state is firmly intent on shaping public opinion and decision-making in the EU.
- The Chinese Communist Party is more confident and explicit in presenting itself to the outside world as a systemic competitor and legitimate alternative to Western liberal democracy in global affairs.
- European countries face three critical and imminent challenges, namely the spread of Chinese propaganda and disinformation in Europe, the capture of elites who act as opinion shapers within European society and self-censorship by those who shape European public perceptions of and discourses on China as a result of Chinese coercion.
- To increase resilience in the face of China's propaganda and disinformation, Europe needs to promote greater media independence and China literacy and raise the costs of engaging in disinformation practices.
- On the issue of Beijing's cultivation and co-option of elites, European governments need to promote stronger rules around transparency, disclosure and the revolving door issue.
- To tackle the issue of self-censorship, the EU and its member states need to facilitate transparency and information-sharing among actors affected by Beijing's coercion while being prepared to counter-retaliate.

1. CRISIS LESSONS: CHINA HAS ENTERED THE MAINSTREAM OF EUROPEAN POLITICS AND POLICY DEBATES

Beijing's behavior towards Europe during the coronavirus pandemic has added fuel to growing debates about China's attempts to undermine the political sovereignty and unity of the EU and its member states. The news that the European External Action Service (EEAS) had temporarily withheld a report on Covid-19 related disinformation activities and softened criticism of China in response to Beijing's pressure stoked a public discussion about Chinese efforts to influence decision-making in European capitals.¹ So too did leaked reports that Chinese officials had asked German counterparts to publicly praise Beijing's handling of the pandemic.²

As the Chinese government sought to garner public praise for its system's superiority in handling the health emergency, and to inhibit criticism of its mistakes, it became increasingly clear that they were prepared to use both overt and covert means to influence European administrations and public opinion. Targeted messaging related to Beijing's supplies of medical equipment to Europe – the so-called “mask diplomacy” – and an initially slow response from the EU allowed China to publicly contrast its generosity with an alleged lack of intra-European solidarity.

For the first time, China has come to matter in European public opinion

The Covid-19 crisis also forcefully exposed a new reality: China is increasingly entering the mainstream of European politics and policy debates. For the first time, China has come to matter in European public opinion and in the making of critical domestic policy choices. Hence, China managed to make inroads in public discourse and influence perceptions in key EU member states, like Italy, as well as in EU candidate countries, such as in Serbia. According to Chinese party-state media, Wang Yiwei, Director of the Centre for European Union Studies at Renmin University in Beijing, suggested that “European countries can't count on the US or the EU to provide them aid, so China sends out humanitarian support to relevant countries at their request,” reinforcing Serbian President Vucic's assertion that European solidarity is a “fairy tale.”³ In April, the EU had offered Serbia a 93 million EUR package to help fight Covid-19.⁴

At the same time, China's divisive rhetoric and non-transparent handling of the pandemic has cast doubts over its reliability as a partner and laid bare the limits of cooperation with a “systemic rival” that, in the words of the EU Commission, “promotes alternative models of governance.”⁵ This has given new impetus to ongoing debates in many European capitals about the need to recalibrate Europe's approaches to China and to limit dependencies. It has dawned on many that, in its handling of Covid-19, China has not been any closer to OECD norms and principles than during the 2003 SARS outbreak. Indeed, in countries like France and Germany public sentiment towards China has worsened as a result of Beijing's policies.

However, this is no time for complacency. The pandemic has confirmed for many that the Chinese party-state is now firmly intent on shaping national public opinion and decision-making in the EU. This is primarily meant to ensure regime security at home, but increasingly also to undercut European citizens' belief in the virtues of liberalism and democracy, and to loosen Europe's geostrategic alignment with the United States and other partners around the globe.

In this regard, Beijing's promotion of propaganda and disinformation to win consent for its domestic and foreign policy goals, both with European elites and the wider public, increasingly poses a challenge to the EU's ability to exercise its political sovereignty and act cohesively. Hence, it is undermining the widespread public support required for the EU to act strategically and to withstand pressure from other great powers. European governments must work together to devise adequate and decisive responses. This will require them to strengthen their resilience to Beijing's influence and learn how to manage dependencies in a way that safeguards European values and interests.

2. CHINA'S TRAJECTORY: THE CCP'S QUEST TO GAIN DISCOURSE POWER POSES CHALLENGES TO LIBERAL DEMOCRACIES

Despite heavily contesting the notion that China is a “systemic rival” to the EU – as the latter has framed it – the Chinese party-state has always seen itself in competition with liberal democracies. Leaked in 2013, the internal CCP Document No. 9 on the state of the ideological sphere in China describes in no ambiguous terms the “political perils” of “Western” principles, values and governance system as threats to CCP rule.⁶ Since Xi Jinping came to power, Beijing has taken more visible steps to prevent the infiltration of foreign ideas, for example by promoting stringent laws on national security – including the latest Hong Kong National Security Law – and tightening control on foreign activities, such as with the January 2017 Foreign NGO Activity Management Law, which *de facto* banned many foreign non-governmental organizations from working in China.

The party is now also more confident and explicit in presenting itself to the outside world as a systemic competitor and legitimate alternative to Western liberal democracy in global affairs. Xi Jinping told CCP cadres at the 19th Party Congress, held in October 2017, that China was ready to “move closer to global center stage” and that its path, theory and system offered “a new option for other countries and nations who want to speed up their development while preserving their independence.”

In its efforts to increase China’s discourse power (话语权) and guide the “reform of the global governance system,” Beijing has tried to constrain the way foreigners talk about China’s rise and the CCP’s core interests.⁷ Under Xi, these activities have intensified. Immediately after taking office in 2013, he told party cadres and government officials to assert Beijing’s vetted narratives on the global stage by “telling China’s story well” (讲好中国故事). In the long term, the CCP aims to make the world more accepting of China’s rise and the spread of its economic and political governance model.

The CCP is more confident in presenting itself to the world as a systemic competitor

Communicating to foreign governments and publics that it is both impossible and undesirable to hinder Beijing’s pursuit of its interests – even where these violate international law or national security – is part of China’s coercive diplomacy. While “wolf warrior” diplomacy might be bad for China’s image, it serves Beijing’s goal of sustaining perceptions of dependency and inevitability, which makes its threats work effectively.⁸

Beijing’s activities to assert its narratives and interests abroad are increasing.⁹ A growing number of Chinese government actors, including the People’s Liberation Army (PLA), consider Western social media platforms like Twitter and Facebook as useful tools to conduct psychological and information warfare with the aim of achieving narrative dominance or interfering in foreign countries’ politics.¹⁰ Several Chinese party-state agencies have also hired media and communication consultancies to expand their presence and narratives overseas.¹¹

Going forward, the spread of Chinese-designed social media apps in Europe, like TikTok, poses additional challenges with their potential to create alternative information ecosystems with censorship embedded in algorithms.¹² At the same time, the CCP’s work to cultivate and co-opt foreign elites or to enforce self-censorship will remain key, if more conventional, pillars of Beijing’s efforts to shape public discourses in Europe and to undermine public support for liberal norms and principles.

3. KEY ISSUES: BEIJING ENGAGES IN DISINFORMATION, ELITE CAPTURE AND COERCIVE DIPLOMACY TO SHAPE THE WAY EUROPEANS PERCEIVE AND TALK ABOUT CHINA

The Covid-19 crisis has underscored that in protecting their sovereignty and unity vis-à-vis China, European countries face three critical and imminent challenges, namely the spread of Chinese propaganda and disinformation in Europe, the capture of elites who act as opinion shapers within wider European society and self-censorship by those who rely on access to China but also shape European public perceptions of and discourses on China as a result of Chinese coercion.

ISSUE 1 - CHINA'S GLOBAL BRANDING ACTIVITIES: PROPAGANDA AND DISINFORMATION

China has taken external propaganda in Europe to a new level

While Beijing has been successful, so far, in hiding its disinformation efforts in the slipstream of Russia's more visible activities in this space, China has taken external propaganda in Europe to a new level during the coronavirus pandemic and thus drawn greater attention to itself. In Italy and Serbia, bot networks helped to promote a positive image of China during the pandemic.¹³ Narratives focused on presenting China and the two countries as close friends, advertising China's (commercial) medical supplies and its success at handling Covid-19.¹⁴ Polls in both countries show that China is seen as giving more assistance than the EU to their populations, despite the reality being drastically different. Roughly 40 percent of Serbians believe that China, and not the EU, is their country's main donor.¹⁵ Italians seem to be similarly convinced that China, not Europe, has been Italy's greatest ally during the pandemic.¹⁶ And while according to the Italian Ambassador to China only around 10 percent of Chinese medical supplies to Italy were donations,¹⁷ 77 percent of respondents in a recent survey think that medical supplies from China were a "gesture of solidarity."¹⁸

Chinese disinformation in Europe (and elsewhere) has resembled Russian-style activities in that it has tried to sow confusion about the origins of Covid-19 by promoting contradicting conspiracy theories, for example, claiming that the virus was brought to Wuhan by the US army while simultaneously spreading stories that it originated in Italy.¹⁹ It also tried to create mistrust between citizens and institutions, such as with a statement by the Chinese embassy in France claiming that French authorities were leaving their elderly to die alone without treatment.²⁰

ISSUE 2 - ELITE RELATIONS: CAPTURING EUROPEAN OPINION LEADERS

In recent years, China has also been increasingly able to draw on the support of European business and government elites to promote a positive image of China in wider European societies. During the pandemic, populist leaders like Hungarian Prime Minister Victor Orbán, Italian Foreign Minister Luigi Di Maio, Czech President Miloš Zeman and Serbian President Aleksandar Vučić – all of whom have forged close political ties with Beijing in recent years – have served as amplifiers for Beijing's narrative.²¹ In addition to capturing elites, Beijing has also been able to influence thinking, discourses and decision-making on China in Europe by injecting and sustaining narratives of economic opportunity and dependency and by highlighting the risks of falling out of favor with the Chinese government.²² European governments have fallen for this strategy, signing political agreements – such as BRI Memoranda of Understanding – and promoting China-friendly policies in the hope of gaining economic returns.

ISSUE 3 - "HARMONIZING" PORTRAYALS OF CHINA: DEPLOYING COERCIVE DIPLOMACY AND ENCOURAGING SELF-CENSORSHIP

Businesses and other groups and individuals who depend on exchanges with China regularly face the dilemma of adjusting their language and behavior to Beijing's expectations or bearing the costs of non-compliance with China's political diktats alone, as was visible during the pandemic.²³ Researchers and journalists have been common targets of China's practice of visa denial. In "educating" the foreign public about the "correct way" of talking about China, Chinese state actors also reward what they consider the right kind of behavior. If "wolf warrior" diplomats have made issuing threats a habit, Chinese embassies have also taken to praise actors whose attitude is in line with Beijing's expectations. Contrasting their reporting on Covid-19 to that of "Western media," the Chinese embassy in Bulgaria issued a statement to "thank and highly appreciate the adherence of the Bulgarian media to professional ethics."²⁴

4. EU-CHINA RELATIONS: EUROPE NEEDS TO PUSH BACK AGAINST CHINA'S ATTEMPTS TO MANIPULATE DEBATES AND PUBLIC OPINION

At the very start of her term as President of the European Commission, Ursula von der Leyen pledged to "define relations with an increasingly assertive China." At least in Brussels, the will to increase Europe's resilience to China's challenges to its sovereignty and unity has grown. EU-led efforts to strengthen the fight against disinformation and to improve European strategic communications or to tackle foreign interference in higher education institutions and research organizations are testimony to this.²⁵ Fair and inclusive implementation of the recovery scheme for post-coronavirus Europe could also go a long way to putting a brake on the spread of Euroscepticism and avoiding situations in which countries look to China as an alternative. However, the EU should not be complacent when it comes to protecting sovereignty and unity in the face of a more assertive China.

At least in Brussels, the will to increase Europe's resilience has grown

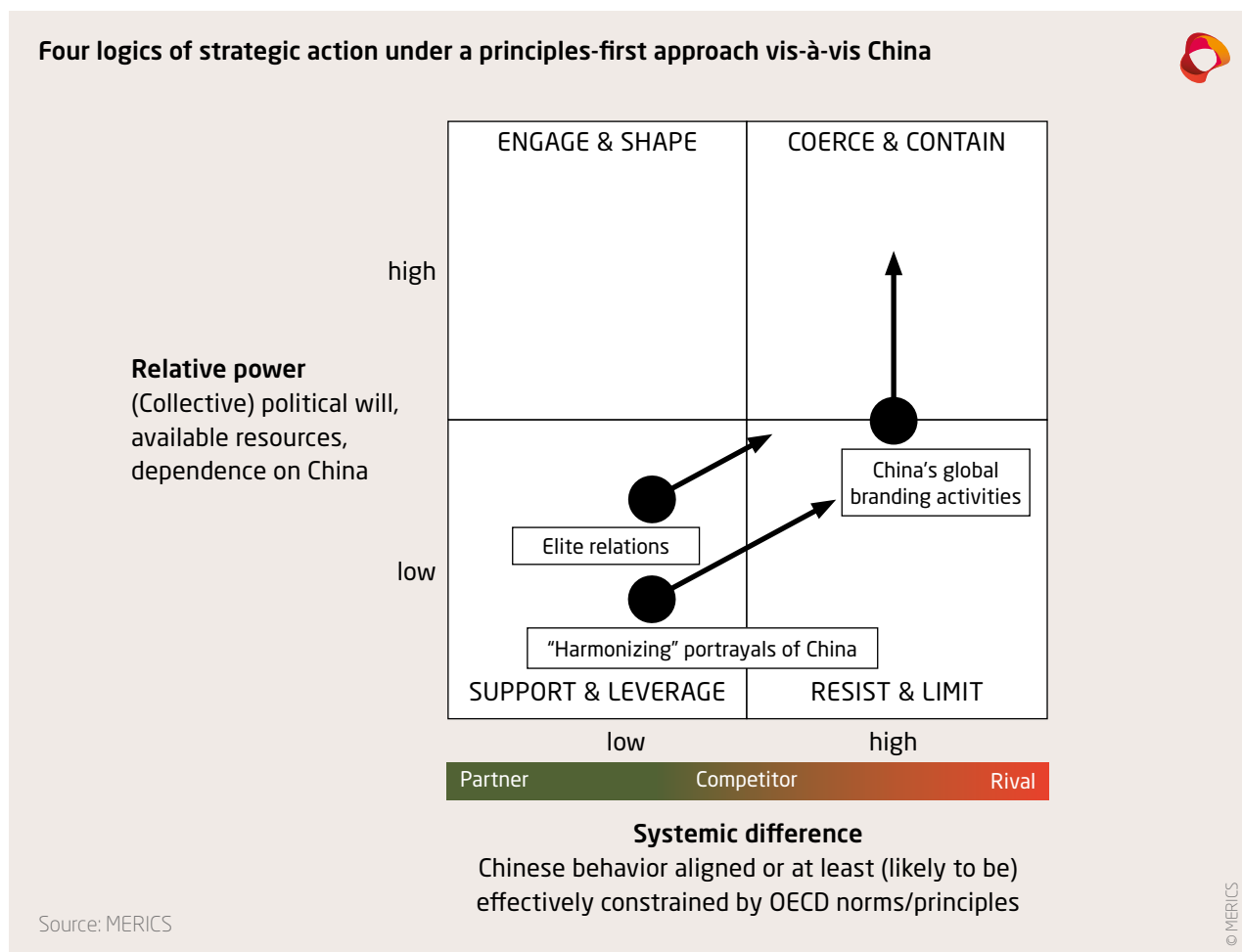
The EU has untapped power to contain Beijing's promotion of propaganda and disinformation in Europe. China still largely depends on Western (social) media to communicate its official narratives to European audiences and to spread disinformation in European countries. Taking advantage of European news outlets' financial struggles and appetite for coverage of China, Beijing has successfully offered money in return for these European media signing media cooperation agreements with and carrying pre-packaged content by Chinese party-state news agencies. This imbalance could be reversed with investment in independent media and China expertise. Brussels recently published a communication on tackling disinformation which fits within the Commission's Democracy Action Plan to strengthen democratic resilience to influence and disinformation activities on social media.²⁶ In 2019, the EU also launched a Rapid Alert System to address disinformation after expanding the focus of its East StratCom Task Force to cover not only Russian but also Chinese activities.

At the same time, there are disagreements among member states regarding how many resources to devote to tackling Chinese disinformation.²⁷ Several EU countries have intensified scrutiny of the Chinese video-sharing app TikTok, but probes have focused on data handling practices and not on network censorship.²⁸ And while there has been some pushback against Chinese paid media supplements²⁹, Beijing has continued to acquire European media and to conclude cooperation agreements with news and broadcasting agencies in Europe.³⁰

In protecting the sovereignty and unity of its member states, the EU must also increase knowledge and transparency around China’s outreach to European political elites. So far, the work of uncovering covert, coercive, or corrupt kinds of Chinese influence among European elites has mostly been carried out by researchers, journalists and NGOs. A more structured and politically supported framework for examining these issues is required. Existing EU and national regulations governing transparency, disclosure and revolving-door issues for opinion-shaping organizations and individuals still largely fail to capture the reality of China’s activities aimed at cultivating and co-opting influential elites.

When it comes to Beijing’s coercive diplomacy and the resulting self-censorship, EU countries have more power than they think, allowing them to at least resist and limit Chinese practices. European governments and industry need to realize that economic interdependence is a two-way street. Beijing is particularly interested in the single market as a source of technological know-how for its ambitious domestic plans. Good economic and political relations with Europe are arguably also important to China as tensions between Washington and Beijing intensify.

Exhibit 2



5. POLICY PRIORITIES: EU MEMBER STATES NEED TO TAKE TARGETED MEASURES TO FURTHER STRENGTHEN RESILIENCE

To increase resilience in the face of China's propaganda and disinformation, EU member states need to promote greater media independence and China literacy, raise the costs for China of engaging in disinformation practices and have each others back. This requires promoting codes of conduct as well as stronger transparency and disclosure requirements for cooperation with Chinese state-affiliated agencies, using high-level media dialogues with China to communicate divergences in approach to the media and to push for reciprocity in the information sphere and combining existing EU media literacy programs with initiatives to teach about China and its political activities in the information domain. Building on the EU sanctions scheme for cyberattacks established in 2019, the EU should demonstrate to China the costs of conducting disinformation campaigns via social media. At the same time, EU member states should display greater solidarity in the face of Chinese pressure, with the summoning of a Chinese ambassador in one member state, for example, leading to similar steps in all other member states.

On the issue of Beijing's cultivation and co-option of elites, European governments need to promote stronger rules around transparency, disclosure and the revolving door issue. European countries can take inspiration from notable examples from the US and Australia, such as the Australian Foreign Influence Transparency Scheme. A dialogue with countries that have for long dealt with China's influence activities – primarily Taiwan but also liberal democracies in the Pacific like Australia and New Zealand – can provide European security communities with great insights and best practices. To tackle the issue of self-censorship, the EU and its member states need to facilitate transparency and information-sharing among affected actors. At the same time, EU member states need to address relevant cases with Chinese counterparts and be prepared to threaten and carry out targeted retaliatory measures in response to Beijing's coercion.

The EU and its member states need to facilitate transparency and information-sharing

2. Safe interdependence: Managing economic vulnerabilities

Caroline Meinhardt

KEY FINDINGS

- The supply chain disruptions caused by Covid-19 and the severity of their impact on Europeans' health and livelihood have heightened existing concerns about Europe's economic dependence on China.
- China has long set its economic policy on a trajectory of strategically managed interdependence that does not converge with OECD norms, requiring a careful rethink of these interdependencies in Europe.
- While China remains a long way from becoming self-sufficient, especially in high-tech industries, in many sectors it has managed to move up the value chain to produce increasingly sophisticated goods for export.
- Europe faces challenging decisions when it comes to securing critical supply chains and assessing the role of Chinese companies in Europe's ecosystem for emerging technologies.
- The EU's dependence on China for life-saving pharmaceutical ingredients and technology-powering batteries are weaknesses that could be exploited by China through coercive tactics.
- To handle growing risks of Chinese economic coercion, the EU should follow the lead of East Asian nations and better compartmentalize its relationship from an "economic security perspective."

1. CRISIS LESSONS: EUROPE NEEDS TO RECALIBRATE ECONOMIC INTERDEPENDENCIES WITH CHINA

When, in late January of 2020, China's economy began grinding to a standstill due to the rapid spread of the novel coronavirus, the ripple effects were quickly felt in the rest of the world. Before long, sustained factory closures in China meant European manufacturers faced shortages of crucial products and components from their Chinese suppliers. Europe's auto and electronics industries were among the hardest hit, but even more concerning were disruptions that carried severe public health implications: Europe experienced shortages in pharmaceutical ingredients and other critical medical supplies imported from China, ranging from personal protective equipment to ventilators, just as the pandemic spread across the region.

The supply chain disruptions caused by Covid-19 and the severity of their impact on Europeans' health and livelihood have heightened existing concerns about Europe's economic dependence on China. The pandemic is now widely cited as a real-life case study that has exposed Europe's trade vulnerabilities and the need to accelerate existing initiatives to increase the EU's strategic and economic autonomy. Meanwhile, fears that Beijing may exploit European trade dependencies to coerce companies or EU member states to toe the Communist Party line are also increasing, adding to these concerns.

The European Commission has long sought to reduce Europe's dependence on other countries for critical materials and technologies, as exemplified more recently by its *New Industrial Strategy for Europe*, launched in March.¹ But the pandemic has created a greater sense of urgency, causing many prominent voices to call for an immediate reassessment of the risks of economic dependence on China. EU politicians are now mulling European production requirements for strategic goods and drawing up proposals for the review of EU supply chain vulnerabilities and the diversification of import sources for critical supplies.² There are widespread calls to strengthen Europe's "resilience" by diversifying European supply chains that are predominantly rooted in China.

However, it would be rash to jump to the sweeping conclusion that Europe must reduce its interdependence with China in all areas of the bilateral economic relationship. As this chapter's analysis of three core issues shows, patterns of asymmetry and dependence vary in scope and risk level across different aspects of EU-China economic relations – from overall trade and investment relations and the EU's reliance on China for critical supplies and products, to Beijing's attempts to control the value chains of foundational emerging technologies. While acute vulnerabilities in some areas of the economic relationship undeniably pose risks to Europe's strategic autonomy and thus necessitate a rebalancing of ties with China, Europe's relative strength in other areas should embolden it to resist Chinese efforts at economic coercion.

Patterns of asymmetry and dependence vary across EU-China economic relations

China has long set its economic policy on a trajectory of strategically managed interdependence that does not converge with OECD norms. Given the long-term competitive risks this path poses to Europe, as well as the immediate vulnerabilities and potential for exploitation of dependencies for political gains, a careful rethink of these interdependencies is needed to strengthen European resilience. The challenge for Europe will be to settle on a unified and coordinated approach to evaluating and managing EU-China economic interdependencies at both the EU and member-state level.

2. CHINA'S TRAJECTORY: MANAGING INTERDEPENDENCE TO MINIMIZE VULNERABILITIES AND CREATE LEVERAGE

China's global importance as a manufacturer and exporter is the result of decades of carefully managed integration into global value chains. Since its accession to the World Trade Organization in 2001, China has rapidly cemented its position as a key producer and exporter of many manufactured goods, especially intermediate goods. Initially dubbed the world's factory due to its abundant supply of low-wage workers, cheap land and relatively lax environmental regulations, China has since moved up the value chain by manufacturing and exporting intermediate goods with increasing value added.³

China's rise to its position as a global manufacturing hub was driven by targeted state measures that incentivize foreign companies to move their manufacturing (and related know-how) into China while supporting China's domestic industrial upgrading efforts. China's industrial policy approach has shifted from prioritizing catching up with foreign manufacturing and technology capabilities to much more ambitious goals. Localizing global supply chains within China, upgrading Chinese industrial capabilities and dominating in emerging technologies from the start are key elements of Beijing's goal to transform the nation into a globally competitive manufacturing and technology superpower by 2049.

For at least the past 15 years, China's leaders have focused on indigenous innovation, core technologies and strategic mega projects to manage China's future interdependence with other countries in technologies. With a web of industrial strategies that have targeted strategic emerging industries and, since 2016, "innovation-driven development," Beijing has sought to capitalize on a new technological revolution to improve the country's relative strength and competitiveness. Its most well-known centerpiece, the *Made in China 2025* initiative, explicitly pushes for substituting foreign manufacturing components and core technologies in strategic sectors with "indigenously" made alternatives.⁴

US restrictions demonstrated to Beijing the urgent need to end its dependence on foreign tech

As Beijing actively strengthened the integration of Chinese industry in global value chains, the government also sought to manage and address the risks of interdependencies that result from deeper economic ties.⁵ It made concerted efforts to vertically integrate Chinese supply chains by reducing the country's own dependence on foreign manufacturing inputs and technology.⁶ The continuing escalation of US-China tech tensions have further fueled Beijing's national security concerns. Chinese companies getting cut off from crucial US-made technology demonstrated to Beijing the urgent need to end its dependence on foreign tech.

While China remains a long way from becoming completely self-sufficient, especially in high-tech industries, in many sectors it has managed to move up the value chain to produce increasingly sophisticated goods for export – and will continue to do so. China's resulting dominance in the production of new technologies such as lithium-ion batteries, and critical supplies such as rare earths, are increasingly causing concern in Europe.

That is because China's strengths in these areas are based on an industrial policy approach that builds on strategically managed interdependence. It fundamentally diverges from market-oriented principles and practices in the OECD. That includes the principle of 'competitive neutrality,' according to which private and state-owned firms should be able to compete on a level playing field.⁷ A major economic policy document, issued by the CCP Central Committee and the State Council in May this year, is an important and timely reminder that China's economic policy-making will continue to pay lip service to the importance of market forces while in reality championing the state-owned sector and strategically aligning the private sector through state intervention.⁸

Even more concerning, China is increasingly leveraging its importance as a supplier of sought-after goods for economic coercion. There are mounting examples of Beijing threatening European governments and individual companies that are dependent on its products with punishment or outright retaliation for acting against its interests.⁹

With China's coercive tactics increasing and unforeseen crises such as the Covid-19 outbreak laying bare the serious risks of economic dependence, Europe will need to systematically reassess certain areas of its economic dependence on China. The deterioration of US-China relations and sweeping efforts to decouple from one another add another layer of urgency: Europe must establish its own position on the risks associated with China's strategically managed interdependence.

3. KEY ISSUES: HIGH-STAKES INTERDEPENDENCE IN TRADE, CRITICAL SUPPLIES AND HIGH-TECH VALUE CHAINS DEFINE EU-CHINA RELATIONS

European decision-makers still hope to conclude an ambitious investment agreement with China. It is therefore imperative that they weigh the benefits of deeper economic integration and the offshoring of manufacturing against the associated risks. Doubling down on an increasingly asymmetric partnership with a state-led and distorted market economy could have serious negative repercussions for Europe's long-term competitiveness and economic security. At a minimum, these efforts need to be accompanied by measures to minimize the risks. In addition to negotiating a Comprehensive Agreement on Investment with the necessary guardrails, Europe faces challenging decisions when it comes to securing critical supply chains and assessing the role of Chinese companies in Europe's ecosystem for emerging technologies.

ISSUE 1 - TRADE AND INVESTMENT: MUTUAL DEPENDENCE AND ASYMMETRIES

The coronavirus crisis has given rise to a new narrative that Europe is overly dependent on trade with China. However, this narrative does not match with official trade data. These show that, on the whole, the EU single market – not China – is by far the most important trading partner for all EU member states.¹⁰ In 2018, the EU single market, on average, accounted for nearly two thirds of total exports of EU member states, whereas China accounted only for an average of 2.4 percent. Of course, trade with China varies across member states. But even Germany, which is generally seen as most vulnerable to Beijing's economic pressures, exported only 7.1 percent of its total exports to China that year, compared to 59 percent to the EU single market.

Furthermore, this narrative fails to take into account the importance Europe plays for China economically. Europe is not only a key export market for China, it also supplies China with goods that are still indispensable given the country's industrial upgrading ambitions. From advanced semiconductor manufacturing equipment to specialized machinery and tools, China needs European technology and know-how as it pursues its goals. Amid escalating US-China tensions and the continual tightening of US export controls, China may come to rely even more on its European suppliers and partners, as Chinese tech companies urgently search for alternative sources for key components and machinery.

Europe supplies China with goods indispensable for its industrial upgrading ambitions

The narrative of economic overdependency, then, may stem from the exposure of individual, large corporates. Germany's private sector is among the most invested in China, with an automotive industry that relies heavily on sales to Chinese consumers, but various major companies headquartered in other European countries – from Dutch semiconductor equipment company ASM International to British metals and mining corporations BHP and Rio Tinto – also rely on China for significant shares of their global revenue.¹¹ Such corporate dependencies open the door to Chinese retaliatory action against European governments, yet it is worth noting that Beijing has rarely followed through on threats to cut off European companies from the Chinese market.¹²

ISSUE 2 - CRITICAL SUPPLIES AND PRODUCTS: PHARMACEUTICALS, PPE AND RARE EARTHS

The coronavirus crisis has also exposed the vulnerabilities of some critical European supply chains that rely considerably on goods or components imported from China. In these specific supply chains, Europe is overly dependent on China, which has implications that go beyond commercial considerations to become a matter of national health or security.

In the medical space, Europe is highly dependent on foreign-sourced active pharmaceutical ingredients (API). Around 90 percent of APIs needed for the European production of generic medicines are sourced from China and India, with India itself 70 percent reliant on Chinese APIs.¹³ China also provides between 80 and 90 percent of the global supply of APIs for antibiotics. When it comes to medical equipment, the EU imported half of its personal protective equipment (PPE) from China in 2018, with an even higher reliance of 71 percent in mouth-nose protection equipment.¹⁴

One step further upstream, Europe also depends on China for metals such as cobalt, platinum and rare earths, many of which are critical materials needed for the production of high-tech products, medical devices and military equipment. The EU remains entirely dependent on imports for its rare earth supplies, most of which come from China.¹⁵

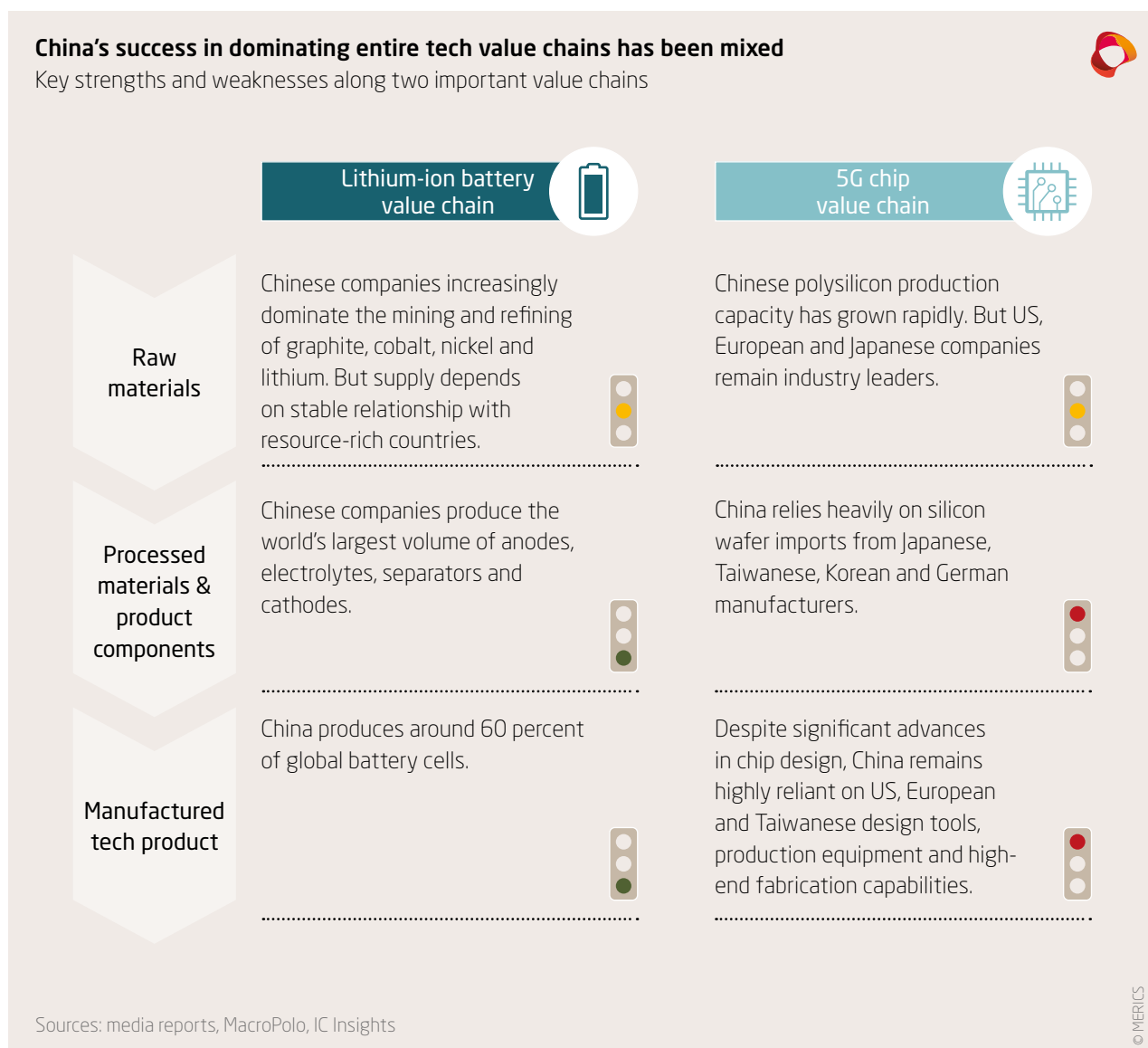
Already aware of these dependencies in critical areas, the EU had started funding several initiatives to tackle such dependencies long before the coronavirus crisis.¹⁶ However, diversifying import sources and repatriating the production of such goods is easier said than done for materials whose production requires large factory sites and causes severe environmental damage. China remains the most competitive environment to produce such materials and, for now, Europe remains vulnerable to any disruptions to these supply chains.

ISSUE 3 - EMERGING TECHNOLOGY VALUE CHAINS: ESTABLISHING CONTROL

China has been particularly keen in its efforts to dominate the global value chains for future technologies, from semiconductors to new energy vehicles and 5G. However, these very technologies have some of the most complex value chains. Fully dominating them would mean controlling the various points at which value is added, from the mining of raw materials, to the assembly or production of various components and the manufacturing of the finished product.

In some areas, China takes charge of the value chain from start to end

In some areas, China boasts considerable success in taking charge of the value chain from start to end. A good example is the value chain for the production of lithium-ion batteries, which power electric vehicles, consumer electronics and new energy storage solutions. Chinese companies dominate the mining and refining of most of the essential raw materials needed for battery production, including graphite and cobalt.¹⁷ Meanwhile, China produces the world's largest volume of midstream battery components, and its leading battery companies, such as CATL and BYD, produce 61 percent of the world's finished battery cells.¹⁸ Europe, which has a global battery cell manufacturing share of only around 3 percent, is highly dependent on importing battery cells as well as the components and raw materials needed for production.¹⁹ Despite EU efforts to scale up Europe's battery manufacturing capacity, many of Europe's upcoming local battery manufacturing facilities are still being built by Chinese companies.²⁰ To ensure consistent battery supply, European car giants are actively deepening their partnerships with Chinese battery makers.²¹



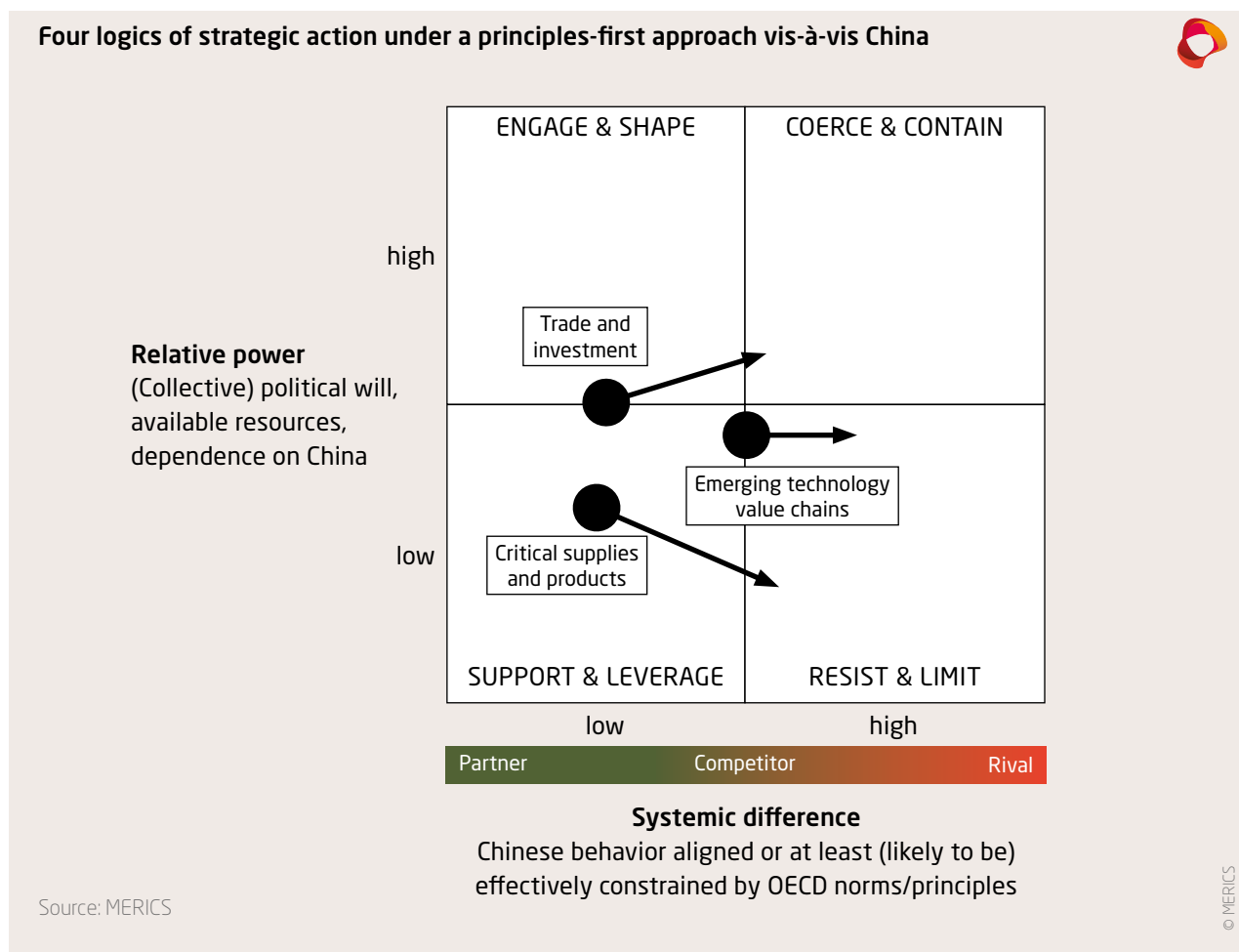
In public debates, China's dominant global role in foundational emerging technology and the resulting dependence of other countries on China, is often exemplified by Huawei's dominance in 5G network technology. According to Huawei, its equipment is being used in two-thirds of the commercially launched 5G networks outside of China and it has secured 47 commercial 5G contracts in Europe.²² Yet at the same time, 5G illustrates the significant weaknesses that remain in China's drive to control tech value chains. Crucial elements needed to build 5G base stations include Field Programmable Gate Arrays, for which Huawei relies on US suppliers Xilinx and Intel. It is also dependent on Taiwan Semiconductor Manufacturing Company, which fabricates the 5G chips designed by Huawei's chip subsidiary using US and Dutch semiconductor manufacturing designs and equipment. Following the tightening of US export controls, Huawei may struggle to procure or produce the chips it needs to build 5G base stations – exposing a major weakness in its technology supply chain.²³

4. EU-CHINA RELATIONS: EUROPE IS LESS BEHOLDEN TO CHINA THAN MOST THINK

The EU is China’s biggest trading partner – it is China’s most important export market and the source of major direct investment and technological know-how. As such, the EU-China bilateral relationship in trade and investment has long been characterized by mutual economic dependence, rather than one-sided European dependence on China. European and Chinese companies trade, compete and cooperate around the world, while benefiting from investments in each other’s markets.

Certain aspects of the EU-China economic relationship, and certain sectors, reveal imbalances that point to European weaknesses vis-à-vis China. Supply shortages in the wake of the Covid-19 pandemic point toward an overdependence on Chinese inputs and imports in certain critical product value chains that make the EU vulnerable in times of crisis. Dependence on China for life-saving pharmaceutical ingredients and technology-powering batteries are weaknesses that could be exploited by China through coercive tactics.

Exhibit 4



However, more broadly speaking, Europe may be less beholden to China in its trade and investment relationship than recent narratives claim. Its biggest source of economic growth still comes from trade within the EU single market, while China itself is highly dependent on European imports of crucial high-tech machinery and chemicals – key European strengths. When it comes to China’s grasp of technology value chains, specifically, China has made considerable inroads. However, it still retains its own weaknesses and dependencies, often to do with the underlying basic research or manufacturing equipment. The EU therefore should not be overly fearful of economic interdependence with China and should have greater awareness of the strengths that give it leverage over China.

5. POLICY PRIORITIES: EUROPE NEEDS TO ASSESS VULNERABILITIES AND TAKE ACTION

The coronavirus crisis has brought to public attention the important risks of Europe’s economic dependence on China. While the pandemic should indeed be seen as a wake-up call, it should not lead to sweeping conclusions that economic interdependence with China is one-sided or harmful in and of itself. While the pandemic has demonstrated the risks of relying on global supply chains with heavy input from China, it has also showed the advantages: when it was Europe’s turn to shut down factories as the virus spread beyond China’s borders, China was able to get back to work and resume production, ensuring a continued supply of goods.

What is needed is a thorough assessment of the risks as well as the benefits of economic interdependencies with China. Europe should adopt a more systematic approach and recalibrate interdependence in a way that addresses European vulnerabilities while building on its strengths. This includes the need for concrete and unanimously accepted definitions of which traded goods and technologies are considered “critical.” It also requires the creation of EU-level mechanisms to support policy responses from an economic security perspective. There can be no blanket approach to building “resilient” or “robust” global supply chains, given their complexities. Different types of interdependencies – across different sectors, among specific value chains and individual corporations – require different policy solutions.

When it comes to the overall trade and investment relationship, the EU will have to change course to rebalance trade and investment relations with Beijing towards greater fairness and reciprocity, as negotiated first best options are likely to fail. While the EU should not overestimate China’s lackluster dedication to market reform or Europe’s own relative power, given certain member states’ or sectors’ relatively larger dependence on China, it should not underestimate the power of collective political action.

Based on a comprehensive audit of national and corporate-level dependencies on China, the EU should pinpoint its strengths and weaknesses and identify areas for coalition-building. Should a unified EU stance fail to advance European interests, it should look to its allies beyond Europe to exert pressure in areas where competitive risks from China’s managed interdependence are unbearable. To handle growing risks of Chinese economic coercion, the EU should follow the lead of East Asian nations and better compartmentalize its relationship from an “economic security perspective.” This would allow it to resist political pressure from Beijing while maintaining a stable trading relationship.

To handle growing risks of Chinese economic coercion, the EU should follow the lead of East Asian nations

Based on EU-level and national-level reviews of strategic industries and specific goods that are critical to national security, the EU should limit its exposure to China through a strategy that prioritizes diversification – and in some cases relocation – of critical supply chains. This will require serious resource commitments to enable the building of manufacturing capacity outside of China. In doing so, the EU should not aim for complete self-sufficiency through reshoring production – this is an unrealistic goal given the complexity of supply chains and China’s considerable manufacturing strengths.

Emphasis should instead be placed on rebalancing away from reliance on a single supplier. In addition to existing plans to stockpile emergency equipment and shore up investment in Europe’s domestic pharmaceutical and rare earth capabilities, the EU should review its other existing trading relationships with allies to identify opportunities for closer cooperation with the aim of reducing dependencies on China in critical, strategic goods. There is also a need for nuanced terminology and strategies so that efforts to strengthen Europe’s supply chain resilience do not slide into trade protectionism.²⁴

To tackle dependencies on China for foundational emerging technologies, new institutional mechanisms fulfilling the functions of an “economic security council” would enable member states and the EU to devise policy responses specifically for issues that lie at the nexus of technology, trade and security. Such mechanisms should be an essential part of the EU’s efforts to constrain the reach of China’s distortive economic and industrial policies; only in this way can the EU ensure that its policies are based on nuanced assessments of both Chinese and European strengths and weaknesses in technology value chains, and that member states are unified in their interpretation of political and economic risk.

The EU should strengthen support for its European ecosystems for technologies such as 5G

To be digitally sovereign, the EU should strengthen support for its European ecosystems for technologies such as 5G, semiconductors and cloud technologies. At the same time, the EU must upgrade its safeguards to mitigate the potential risks stemming from the inevitable involvement of Chinese companies in European development of future technologies.

Finally, any European strategies to recalibrate global supply chains must be developed in close consultation with European firms, given the difficulties of adjusting complex value chains. Thus far, political rhetoric on the need for supply chain relocations has not yet translated into major corporate action. European companies are expressing concerns over the financial and logistical challenges of adjusting operations – all of which could take years. Continually growing market demand in China also means that many European companies will continue to pursue an “in China for China” manufacturing strategy. The EU must take into account industry representatives’ perspectives in order to conduct realistic scenario-planning and ensure the effectiveness of policy support measures.

3. Competing with China in the digital age

Rebecca Arcesati

KEY FINDINGS

- China sees the Covid-19 pandemic as an opportunity to rebuild its economy by putting digitalization first, in line with existing goals and plans.
- The crisis has not altered China's state-driven industrial and technology policymaking. The pandemic and decoupling from the US have added urgency to Beijing's indigenous innovation drive.
- For Europe, economic competition with China is increasingly playing out in the digital domain and new technologies. policymakers will be forced to integrate previously marginal policy issues into their China strategies.
- When it comes to collaboration with China in research and innovation, a risk-based approach is needed to prevent unwanted tech transfers.
- China's need for European technology and know-how, for instance in intelligent manufacturing and the industrial internet, could be leveraged to advance EU interests by making access and partnerships conditional.
- The EU will need to join forces with partners around the world if it wants to attain digital and technological sovereignty.

1. CRISIS LESSONS: COVID-19 HAS GIVEN CHINA'S DIGITAL TRANSFORMATION TOP-LEVEL ATTENTION

Chinese leaders' response to Covid-19 has underscored their longstanding ambition to turn China into a high-tech superpower, with digital technologies spurring innovation and transforming the economy.¹ As the crisis unfolded, the government worked closely with technology companies to tackle the emergency.² However, the pandemic also accelerated a broader trend: Much like the EU, China has identified the coronavirus as an opportunity to rebuild its economy by putting digitalization first.³

There is work to be done – while the lockdown boosted China's consumer-facing digital economy, digitalization in traditional industries like manufacturing is still lagging.⁴ Xi Jinping's leadership wants this to change and therefore gave digital transformation top-level attention during the outbreak.⁵ As the country was hit by the virus, 5G network construction was ramped up. The technology, which is set to power the industrial Internet of Things (IIoT) along with intelligent vehicles, smart health systems and other disruptive applications, is a strategic priority of the Chinese Communist Party (CCP). The Ministry of Industry and Information Technology (MIIT) instructed telecom carriers and local governments to “forcefully advance 5G network construction.”⁶ By the end of this year, Beijing wants to have over 600,000 base stations.⁷

For Europe, economic competition with China is increasingly playing out in the digital domain and new technologies. The EU has begun to address China's state-driven technology ambitions in the context of two major policy challenges – strategic acquisitions of European technologies and the presence of high-risk vendors Huawei and ZTE in the continent's

digital infrastructure. This year has seen the implementation of the defensive strategy Brussels crafted in response, with EU investment screening rules and cybersecurity measures for 5G now in the adoption phase.⁸ However, this is merely the beginning of work on a necessarily more strategic EU response to China's technology and digital policies – and member states are far from united on the matter.

Post-pandemic China will remain the formidable “economic competitor in the pursuit of technological leadership” the previous European Commission (EC) described in its March 2019 Strategic Outlook.⁹ Despite government calls for marketization and encouraging openings to foreign investors, Beijing will not abandon state capitalism and techno-nationalist policies any time soon.¹⁰ With economic recovery plans forcing both Europe and China to look inward, and negotiations for a bilateral investment agreement moving slowly, it looks increasingly unlikely that there will be progress on rebalancing economic relations within the year.¹¹

Against this backdrop, policymakers will be forced to recalibrate their strategies in ways that reflect China's policy direction and will have to integrate previously marginal policy issues. This chapter focuses on three specific dimensions:

- (1) If member states want to prevent unwanted tech transfers to China, they need to look beyond Chinese Foreign Direct Investment (FDI) and come to terms with the way Beijing utilizes foreign research collaboration as an industrial policy tool.
- (2) A realistic assessment of China's standardization strategy for ICT and emerging technologies would help European actors better understand where their competitor is headed.
- (3) Distortions in the digital economy caused by state interference should feature more prominently in ongoing debates on reciprocity and fair competition.

2. CHINA'S TRAJECTORY: COVID-19 AND DECOUPLING FROM THE US ADD URGENCY TO INDIGENOUS INNOVATION DRIVE

The coronavirus crisis has not altered China's state-driven industrial and technology policymaking

The coronavirus crisis has not altered China's state-driven industrial and technology policymaking. The latest business confidence survey conducted by the European Chamber of Commerce in China shows that Covid-19 has, rather, exacerbated existing trends: European businesses are experiencing an increasingly politicized environment and persistent market barriers in critical sectors, like ICT, and they expect state-owned enterprises to gain more opportunities at the expense of the private sector.¹² The rollout of 5G illustrates the contradictions of China's economic strategy, with selective opening in some sectors and protectionist industrial policy elsewhere. As of April, domestic vendors had secured 90 percent of the multibillion 5G contracts already awarded by state-owned telecoms operators.¹³

But the issues around 5G are not only about market access: 5G is where the Chinese government's technology policies and national security priorities converge. The CCP's top priority is to reduce reliance on foreign technology, which it sees as an existential threat. Mounting tensions with Washington have only accelerated China's quest for indigenous innovation, as decoupling in hardware, software and even science and talent exchanges becomes a reality.¹⁴ The upcoming five-year plan (2021 – 2026) is expected to place a heavy focus on homegrown technological innovation to further ease China's dependence on the United States.¹⁵

From EV chargers to 5G networks: Beijing boosts technology deployment under “new infrastructure” banner



Illustration of key targets and relevant example projects

Type	Main goal	Key domestic players	Example of related local government or corporate initiative
5G network infrastructure 	Triple the number of 5G base stations across the country to 600,000 by the end of 2020 and have 5 to 5.5 million by 2025 to achieve nation-wide coverage	Ministry of Industry and Information Technology (MIIT); China Broadcast Network; China Telecom; China Unicom; China Mobile; Huawei; ZTE	Shenzhen: 45,000 base stations by end of August, part of RMB 411.9 billion (EUR 49.4 billion) planned investment in new infrastructure until 2025
Industrial internet platforms 	Build three to five internationally competitive industrial internet platforms by 2025, with 300,000 participating companies by 2020, to support the digital transformation of enterprises	Ministry of Industry and Information Technology (MIIT); Alibaba; Inspur; Huawei; CASIC; XCMG; Yonyou; Haier; Shanghai Baosight; Xiaomi; JD; other companies	Jiangsu: One national, cross-sectoral platform and 70 provincial-level platforms. Close partnership with Huawei for industrial internet and Internet of Vehicles
AI innovation zones 	Build 20 “AI Innovation and Development Pilot Zones” across the country by 2023	Ministry of Science and Technology (MOST); Baidu; Tencent; Alibaba; SenseTime; Hikvision; Megvii; Yitu; Huawei; CloudWalk; iFlyTech; other companies; research institutes	Beijing: first AI pilot zone launched in China (February 2019). Ten further zones announced across the country as of August 2020
Big data centers 	Accelerate the construction of big data centers across the country by 2025, sharpening the focus on industrial big data and intelligent computing	Tencent; Alibaba; Baidu; Huawei; Lenovo; Sugon; other companies	Alibaba: three new hyperscale data centers opened in Nantong, Hangzhou and Ulanqab; one million servers over next three years as part of RMB 200 (EUR 23 billion) investment plan to expand cloud infrastructure
Electric vehicle charging stations 	Add 12,000 additional EV charging stations and have 4.5 million charging points by 2020	State Grid Corporation of China; Qingdao Teld New Energy; Star Charge; Potevio; Jiangsu YKC; EV Power; Huawei; Alibaba; other companies	Shanghai: 100,000 new EV charging stations by 2022; construction of the country’s leading Internet of Vehicles infrastructure including 50 kilometres of autonomous vehicles test roads

Sources: CCID think tank; media reports; central and local government documents; industry associations; company websites

To this end, China's innovation policy relies heavily on central planning. Recent calls to liberalize the allocation of production factors, including technology and data, are therefore not likely to lead to structural shifts.¹⁶ It is reasonable to expect continued reliance on interventionist industrial policies designed to nurture indigenous innovation, especially for the development of 'strategic emerging industries' (SEI) – sectors that Beijing has decided to bet on in order to transform the economy and climb up value chains.¹⁷ In February, the MIIT identified nine SEI as policy priorities in restarting the pandemic-battered economy.¹⁸ The fact that the national memory chip champion YMTC and US EV company Tesla were given preferential treatment, so that they could operate amid the lockdown, is evidence of Beijing's determination.¹⁹

The Covid-19 crisis has catalyzed the push for digital transformation and hi-tech development.²⁰ The term 'new infrastructure' (新基建) – from 5G and industrial internet platforms to data centers and artificial intelligence (AI) – emerged as a major policy focus in post-pandemic stimulus measures.²¹ The goal is to speed up the adoption of digital and emerging technologies and their integration with traditional industries, in order to stimulate new growth drivers and boost China's future competitiveness.²² Although the bulk of Beijing's infrastructure stimulus will go to traditional projects, a think tank under the MIIT expects total investment in new to reach 10 trillion yuan (1.3 trillion euros) by 2025.²³

3. KEY ISSUES: FILLING GAPS IN EUROPE'S TOOLBOX TO ADDRESS CHINA'S STRATEGY FOR TECH SELF-RELIANCE

Technology and the digital realm have become terrains of great power competition

With Beijing accelerating its bid for self-reliance and global leadership in key technologies, Europe must brace for challenges. Europeans may not be used to seeing technology and the digital realm as terrains of great power competition, but shifting global trends force a rethink. The pandemic and an ever-fiercer contest for technology dominance between Washington and Beijing provide opportunities for Europe – even though it was a net loser in the first waves of the digital revolution – to revise policies around a number of critical issues set to influence technological and industrial competitiveness in the years to come.

ISSUE 1 - RESEARCH AND INNOVATION (R&I) COOPERATION: DOUBLE-EDGED SWORD

China already matches the EU-28 in R&D intensity, while Chinese companies have been increasing their investments in research much faster than their European competitors.²⁴ Despite pandemic-induced budget constraints R&D remains a priority, especially in basic research and core technologies.²⁵ China's vibrant innovation system offers tremendous opportunities for European firms, and Covid-19 has brought the importance of cross-border innovation into the spotlight. Europe could also benefit from attracting more talent flows as Chinese STEM researchers face growing barriers in the US.²⁶

Despite these opportunities, the lack of reciprocity in bilateral R&I ties is still a problem, particularly in terms of funding, data-sharing and IP protection.²⁷ Even more importantly, collaboration with China requires substantial investment in risk assessment and due diligence. China's foreign research collaboration strategy poses long-term risks for Europe's competitiveness, security and values. China's government seeks to leverage collaboration for industrial policy goals.

Europe needs to brace itself against unwanted tech transfers

Selected cases involving Chinese actors



Vector	Description	Country
Investments and acquisitions	Acquisitions of advanced semiconductor technology are instrumental for the Chinese government's pursuit of technological independence. UK semiconductor company Imagination Tech was acquired by Chinese private equity group Canyon Bridge, which is backed by a state-owned investor. The Chinese owner recently tried to seek control of the company, prompting an investigation.	UK
R&D collaboration (academia)	Researchers at Aalborg University collaborated with Hikvision to create an algorithm that tracks how online sentiments change, which could also be used for social repression. The researchers ignored that Hikvision, a leading manufacturer of surveillance equipment, is heavily implicated in human rights abuses in China's Xinjiang region.	Denmark
R&D collaboration (government)	Part of the know-how needed to build China's dual-use satellite navigation system, Beidou, reportedly came from the Galileo technology partnership between the Chinese government and the EU, which was dissolved due to controversies between the two sides.	Belgium
R&D collaboration (corporate)	Siemens has a strategic cooperation agreement with CETC aimed at testing and developing intelligent manufacturing solutions in electronic information. The state-owned military contractor is behind a computer platform used by the Chinese police for the surveillance and internment of ethnic minorities in Xinjiang.	Germany
Exports	Germany-based MTU supplied state-of-the-art diesel engines for PLA submarines.	Germany
Industrial espionage	Employees of Dutch chip machine maker ASML reportedly stole trade secrets and passed the information to competitor XTAL, which is owned by a Chinese company with ties to the Chinese Ministry of Science and Technology. ASML denied finding proof of Chinese government involvement in the theft.	The Netherlands
Academic espionage	A Chinese doctorate student and his supervisor were expelled from Norway after it was found that their research could be used by the Chinese military to develop hypersonic cruise missiles. The scientist had deliberately concealed his affiliation with the institution training the PLA's strategic missile forces.	Norway
Cyber theft	Chinese spies hacked Britain's largest defense company BAE, stealing sensitive data related to the multinational F-35 Joint Strike Fighter (JSF) project. Experts have warned that the PLA may have used the stolen data to build its own stealth fighters. Information was also stolen from US companies involved in the JSF program.	UK

Sources: media reports; ASPI; Human Rights Watch

Transferring foreign talent and technology is a strategic priority, accomplished through a sophisticated web of legal, extra-legal and illicit channels.²⁸ These range from setting up science parks and tech transfer centers and attracting European R&D to China, to sending military scientists to universities and engaging in industrial espionage.²⁹ In some cases, Sino-European partnerships have contributed to China's military technology R&D, or efforts to perfect mass surveillance.³⁰ Against this backdrop, a shift to a more clear-eyed approach to R&I collaborations with Chinese actors is overdue.

ISSUE 2 - STANDARDIZATION: TECHNOLOGY SPECIFICATIONS MEET CONNECTIVITY ALONG THE DIGITAL SILKROAD TRAIL

Europe must also come to terms with China's strategic approach to technology standardization, starting with a realistic assessment.³¹ Chinese companies' growing participation in standard-setting bodies and the standardization of emerging technologies (AI, 5G and IoT in particular) is entirely normal and critical for ensuring safety and interoperability; their market shares will depend on the quality of their technology and their success at commercializing it.³² At the same time, Beijing sees standardization as a tool for strengthening indigenous innovation.³³ To that end, it actively promotes and sponsors Chinese companies' participation in international standard-setting bodies.³⁴ Cases of firms forming coalitions to support domestic industrial policy goals have already emerged.³⁵

China is attempting to blend digital connectivity and standardization

Beijing also pushes the internationalization of Chinese technical standards in a range of industries through the BRI, with a strong focus on ICT, emerging technologies and the integration of these with industrial production.³⁶ By building fiber-optic cables, smart cities, data centers and digital service platforms, while encouraging developing and emerging economies to adopt Chinese standards as part of the Digital Silk Road (数字丝绸之路, DSR), China is attempting to blend digital connectivity and standardization and to leverage the lower cost of Chinese standards compared to Western alternatives.³⁷ While the content of most DSR memoranda of understanding (MoUs) is undisclosed, evidence points to an increased emphasis on standardization cooperation.³⁸ By 2019, China had signed 85 standards cooperation agreements with 49 countries and regions along the BRI.³⁹

This year, China will release a national standardization strategy incorporating the results of the 'China Standards 2035' project (中国标准2035项目), a major research effort aimed at streamlining the national standardization system and promoting Chinese standards globally.⁴⁰ Next-generation technologies like IoT, cloud computing, big data, 5G and AI are a focal point of this strategy.⁴¹

European businesses have long been concerned about the closed nature of Chinese standardization committees.⁴² If they were excluded from the 'China Standards 2035' process, while Beijing succeeded at exporting its preferred standards through the DSR, the playing field in the digital economy could be tilted in favor of Chinese competitors. Meanwhile, Chinese firms' first-mover advantage in the standardization of applications like facial recognition means China could acquire a greater say in emerging technology governance, thereby promoting interests that are not necessarily aligned with European ones.⁴³

ISSUE 3 - DIGITAL ECONOMY: EXPANDING THE REMITS OF UNFAIR COMPETITION

As EU Commissioner Thierry Breton put it, we are witnessing a "global battle for industrial data."⁴⁴ Like Brussels, the Chinese government is also upping its game to unleash the untapped potential of data in upgrading industry and transforming the economy through

platform business models and technologies like IoT, AI and cloud computing. Unlike internet users' data, data from production plants and machines in China is not yet shared and used to create value. The government wants this to change. While these efforts date back to the 2015 'Internet Plus' action plan, there is now a stronger focus on the industrial internet and the creation of an industrial big data system by 2025.⁴⁵

Data security is a top priority for Chinese regulators and a matter of national and regime security. This encourages them to place sweeping restrictions on the collection, processing and cross-border transfer of personal and 'important' data. On July 1, the draft 'Data Security Law' was released for public comment.⁴⁶ By introducing a system for grading and regulating data, including industrial data, based on its importance for national security, the law could heavily impact foreign business. The law also codifies China's ability to retaliate against any country imposing trade and investment restrictions towards the PRC related to data and technology. These developments could further politicize the treatment of foreign technology in China and exacerbate competition distortions in the digital economy.

Data security is a top priority for Chinese regulators and a matter of national and regime security

Lastly, the EU and members states should also pay more attention to the DSR since Beijing is leveraging it to promote and finance the global expansion of domestic technology companies.⁴⁷ Despite the growing backlash against Huawei in developed countries, the unmet needs for digital connectivity in developing and emerging economies will continue to provide fertile ground for Chinese ICT and digital projects. These often consist of integrated hardware and software packages provided by state-backed companies, with the potential outcome of creating China-centered digital ecosystems in which European companies cannot participate.⁴⁸ Already dominant in China's closed digital market, Chinese tech giants could control increasing amounts of data and create entrenched monopolies in third markets.

4. EU-CHINA RELATIONS: LEVERAGING CHINA'S TECH DEPENDENCE BECOMES A PRIORITY FOR THE EU

Europe plays a central role in Beijing's high-tech ambitions. Despite increased scrutiny, most Chinese transactions in the then EU-28 in 2019 were in the ICT sector.⁴⁹ This is consistent with the trend of Europe being both target (through acquisitions) and willing partner (through R&D collaborations) of Beijing's MIC2025 strategy.⁵⁰ Additionally, European firms have experienced an increase in forced tech transfers in recent years.⁵¹ As China finds its access to US technology increasingly curtailed, it is likely that it will turn to Europe for alternatives. This is already happening in the semiconductor value chain, for example.⁵²

It was the appreciation that Europe's competitiveness and economic security were at risk that already led to a significant change in EU China policy. Following Brussels' call, more member states are adopting or upgrading investment screening tools and reconsidering the role of Chinese vendors in their digital infrastructure. Moreover, as part of an ambitious work program launched by the previous EC to fill gaps in the EU's defensive toolbox, reform proposals have been advanced in competition, trade and public procurement policy.⁵³

Despite these achievements, the EU and member states cannot effectively compete in the Fourth Industrial Revolution by only playing defense. To preserve the continent's digital and technological 'sovereignty', in February the EC therefore unveiled new industrial,

digital and data strategies aimed at strengthening EU competitiveness, making sure that the bloc masters critical technologies, especially AI.⁵⁴ Although the European concept of digital sovereignty is sometimes conflated with China's approach to the governance of cyberspace, its rationale differs fundamentally from China's, where state control over data and the digital economy is first and foremost a tool of information control.

The EU has many cards to play

Having rightly identified the nexus between industrial, competition and digital policy-making, the EU now needs to implement its offensive agenda. Momentum is building across the bloc and in the UK, a key partner in the technology and innovation contest with China. In a major shift, London decided to fully exclude Huawei from its 5G networks, and major EU economies like Italy are also placing restrictions on the company's involvement in network rollouts.⁵⁵ Meanwhile, Paris and Berlin are elevating the importance of digital and industrial policies as pillars of the post-pandemic recovery.⁵⁶

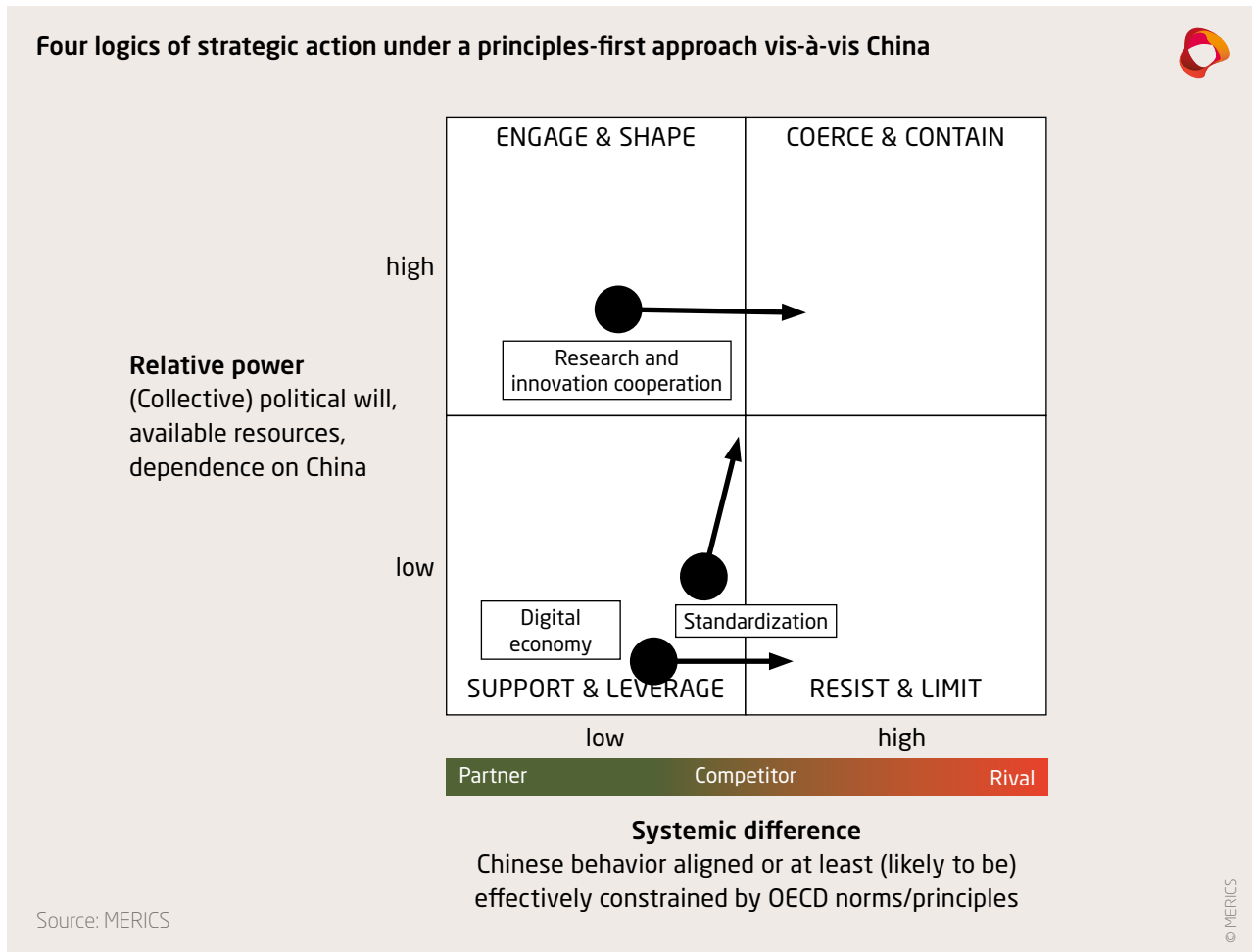
The EU has many cards to play, starting from a world-leading science and innovation base, talent and lots of cutting-edge technology; the challenge is to overcome longstanding weaknesses in terms of digital market fragmentation, regulatory hurdles and under-investment in scalable tech businesses.⁵⁷ China, by contrast, is very good at funding and commercial adoption of digital and emerging technologies. It has large digital businesses that adopt technology quickly and foster dynamic ecosystems – both domestically and increasingly also overseas – taking advantage of a favorable regulatory regime at home.

That said, the EU has some relative strength vis-à-vis China. For one, investing in internal capabilities and enforcing EU rules in the single market is unlikely to provoke substantial backlash on the Chinese side. Meanwhile, China's need for European technology and know-how, for instance in intelligent manufacturing and the industrial internet, could be leveraged to advance EU interests by making access and partnerships conditional. The bloc's relative power is high when it comes to R&I and standardization, both areas where Beijing is eager to partner with European institutions and industry. However, the EU is quickly losing ground as an innovation and standards power while China is doubling down on investment in these fields.

5. POLICY PRIORITIES: EUROPE NEEDS TO TRANSLATE INDUSTRIAL AND DIGITAL STRATEGIES INTO ACTION

The new EC's offensive agenda, which considers technology and the digital sphere to be critical elements in today's geopolitical competition, is Europe's best chance to respond to China's bold plans for high-tech leadership. Planned investments in 5G, AI, cloud, cybersecurity and green technologies as part of the EUR 750 billion post-pandemic recovery package are steps in the right direction.⁵⁸

A challenge for Europe will be to position itself strategically as the US-China tech conflict heats up. Fully applying defensive tools to protect technology and critical infrastructure will be key, as restricted access to American technology forces Chinese firms to look elsewhere. Additionally, companies will need to adjust their scenario planning constantly to navigate the partial decoupling of American and Chinese tech ecosystems. Policymakers will face increased pressure to think even more strategically across policy domains and competences, which requires setting up new structures to tackle risks associated with emerging technology ties with China.⁵⁹



When it comes to R&I, a risk-based approach is needed to prevent unwanted tech transfers. This means shifting to a logic of coercing and containing with regard to those aspects of China's cooperation strategy that threaten Europe's competitiveness, security and values. It will be necessary to raise awareness among member states, universities and businesses and draft guidelines for R&I partnerships with Chinese entities, including red lines for partners and technologies that are off-limits. Aside from curbing unwanted tech transfers, increasing the Horizon Europe Program budget to EUR 120 billion, as recommended by the European Parliament, would boost the EU's ability to compete on the global stage.⁶⁰

On standardization, EU actors need to coordinate their lobbying efforts in China, especially in the context of China Standards 2035, as it is in the EU interest to engage and shape and promote emerging market-oriented forces.⁶¹ More resources should also be invested to help companies understand the standardization dimension of the DSR, while member states' standards cooperation format with China – such as the Sino-German Industry 4.0 Cooperation – should be leveraged whenever possible to achieve *European* regulatory objectives in the Chinese market.⁶²

In international standard-setting bodies, Europe does not need to copy China's state-led strategy to invest more resources and ensure continued relevance of its businesses. Beijing and Washington see standardization as terrain for geo-economic competition. If it wants to retain its industrial competitiveness in the digital age, the EU should shift from an overly technical to a more strategic approach.⁶³ Breton's recent call for greater EU engagement in the standardization of lithium for EV batteries in response to China's proposal to set up a new committee was timely.⁶⁴ The EU should also be prepared, in consultation with industry and like-minded countries, to coerce and contain China when it manipulates standard-setting processes.

As China seeks access to Europe's technology and digital market, Brussels and member states should insist on digital reciprocity as a new principle in bilateral relations. China's protected digital market, discriminatory standards and data regulations hurt the competitiveness of European businesses, and they are now being exported through the DSR. As it works on creating a unified data market, the EU should explore ways for making Chinese companies' access conditional.

The EU will need to join forces with partners around the world

Navigating China's emerging data regulations will be challenging, as the government will not change its approach to data security. Europe can only resist and limit. As it sets out to measure cross-border data flows and address unjustified obstacles as part of its European Strategy for Data, the EU should monitor competition distortions arising from unequal access to data in the Chinese market. The monitoring should include third markets where Chinese ICT and Internet players are creating new digital ecosystems, as data-driven market power or anticompetitive practices may arise.

Lastly, the EU will need to join forces with partners around the world if it wants to attain digital and technological sovereignty.⁶⁵ Many aspects of the China challenge, from forced technology transfers to digital protectionism, cannot be confronted alone. The UK's recent proposal to set up a group of like-minded democracies to fund secure 5G solutions is worth exploring.⁶⁶ For example, such grouping could invest in secure, sustainable and affordable digital connectivity in the developing world, thereby providing alternatives to China's DSR. At stake is not just Europe's competitiveness, but also its strategic autonomy and the very democratic values and fundamental rights it wishes to promote in the digital transformation.

4. Advancing liberal multilateralism

Mikko Huotari and Katja Drinhausen

KEY FINDINGS

- The introduction of the National Security Law in Hong Kong, its behavior in Xinjiang have called into question China's willingness to operate within the framework of a rules-based international order.
- European actions in the coming months and years will have to aim at containing the effects of the Chinese party-state's illiberal policies.
- Regarding human rights, European measures will have to move beyond the failed quiet diplomacy approach.
- In terms of updating global rules for trade, Beijing's current trade policy profile does not make it a natural partner for the EU.
- In the digital arena there are still limited opportunities to shape China's approaches to improve data security and facilitate cross-border data flows.
- The EU's connectivity strategy can provide an answer to key challenges associated with China's Belt & Road Initiative. But only a financially bolstered approach will have real impact.

1. CRISIS LESSONS: THE LIBERAL GLUE OF GLOBAL MULTILATERALISM IS UNDER THREAT

Liberal multilateralism will not survive 2020 unscathed – and a key reason for that is China's corrosive impact. This year will be remembered not only for the Covid-19 pandemic but also for China disregarding its international obligations as enshrined in binding international treaties. With the introduction of the National Security Law for Hong Kong, Beijing has pushed through long-standing plans to exercise greater control in the city. In so doing, it has called into question China's willingness to operate within the framework of an already fragmented rules-based international order.

The Covid-19 crisis has also shown how effective Beijing has become at instrumentalizing multilateral institutions, including the UN and its organizations, to promote its positions and narratives – such as on the pandemic's origin and spread – and to gather praise for its contributions and approaches. These efforts were also visible in July 2020 when Beijing was able to coalesce a group of countries in the Human Rights Council to provide it with “landslide support” against a motion that criticized its measures in Hong Kong. This vote revealed once again the striking overlap between countries that Beijing can win over for political support in multilateral institutions, those that score as less “free” in relevant indices measuring democratic freedoms and those that receive Chinese bilateral financial and development support.

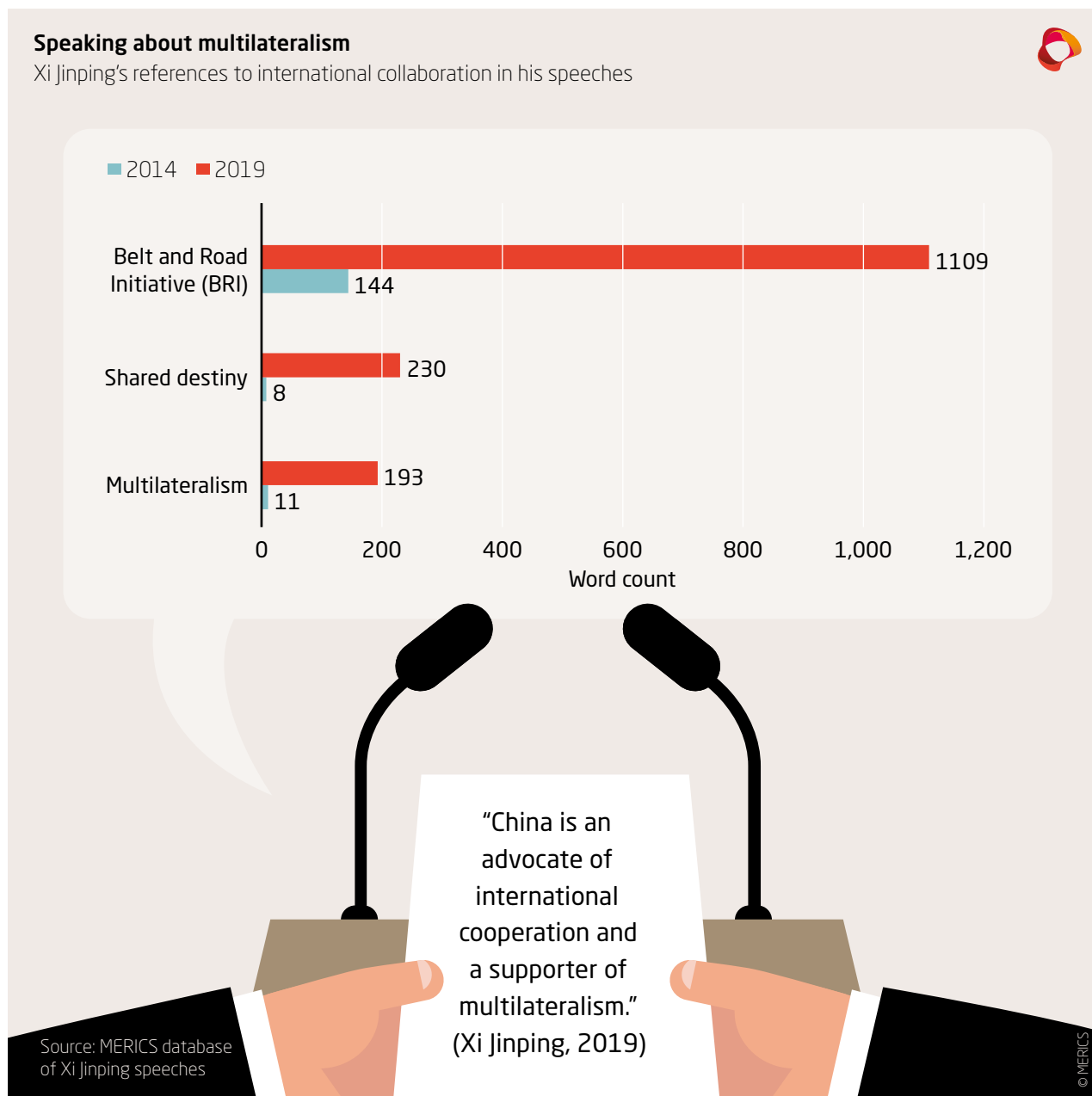
Like-minded liberal OECD countries face a long-term systemic challenge to fortify and revitalize liberal approaches embedded in multilateral institutions against Chinese efforts to undermine and instrumentalize existing global institutions to promote its state-centered and authoritarian goals. With the United States' retreat from global multilateralism and its deepening domestic crisis, European leadership in this arena matters greatly.

Going forward, European action – or lack of it – on three specific challenges will play a major role in determining member states’ and the EU’s positioning in a shifting global power environment:

- (1) how to deal with China’s instrumental approach to multilateralism and its selective disregard for existing treaty obligations;
- (2) how to respond to the erosion of liberal multilateralism’s substance, specifically with regard to human rights and development issues; and
- (3) how to engage China in updating existing and negotiating new norms and rules for arenas in which principled conflicts will be expressed in the future, most notably trade and the digital space.

Despite Beijing’s claims to be a standard-bearer for global multilateralism, China’s actual approach is likely to clash more often and in more fundamental ways with OECD principles and European interest.

Exhibit 8



2. CHINA'S TRAJECTORY: TOWARDS A LOWEST-COMMON DENOMINATOR MULTILATERALISM SAFE FOR THE CCP

The PRC's role and influence in global multilateral institutions has changed dramatically since it first took its seat in the United Nations (UN) in 1971. China's strengthened influence is a direct reflection of its growing economic and political clout, and the result of a steep learning curve on how to engage in these organizations in a way that best serves its interests. China today prides itself in being a member of almost all inter-governmental organizations and a party to more than 500 multilateral treaties.¹ In practice, Beijing pursues a highly differentiated approach to global governance, attempting to shape institutions from within, ignoring commitments when these are at odds with its interests, resisting liberal substance and circumventing existing frameworks for multilateral engagement while building new ones.²

China's leaders focus their efforts on the limited number of international institutions within the UN structures of which China is an equal member. They see only the IMF and the World Bank, the WTO and the newly embraced G20 as sufficiently power-balanced, controllable and non-intrusive. Beijing might recognize multilateral forums as valuable tools, but it does not accept the validity of universal rules and principles imposed on nations.

Beijing sees multilateral forums as valuable tools

As a prominent Chinese scholar has expressed it: “The existing liberal international order is at odds with the domestic order led by the Chinese Communist Party within China.”³ The Chinese party-state sees the liberal normative framework, and especially the focus on liberal democratic institutions, individual human rights and inclusion of non-governmental actors as key stakeholders, as a threat to the legitimacy and political security of the CCP. Selective and instrumental multilateral cooperation thus serves Beijing's domestic policy approaches as prioritized by the CCP leadership: focusing on sovereignty, state authority and regime security and economic development rights as global priorities.

Xi and his strategists' vision is reflected in the benign-sounding concept that Chinese diplomats have been pushing since 2013: “a community with shared future for mankind.” In practice, this vision emphasizes absolute national sovereignty over all domestic matters, “political pluralism” – i.e., equal acceptance of authoritarian forms of governance and their contributions to international rule-shaping – as well as “common values,” meaning a lowest common denominator negotiated by states.

Ultimately, China wants to pre-empt international pushback and questioning of its tactics such as it is currently experiencing over Hong Kong and the Xinjiang human rights crises. Framed as “democratic representation in international governance,” Beijing seeks to reshape the power structures and principles underpinning existing multilateral forums and establish alternative platforms for engagement to reset global standards and “break the hegemony” of Western nations.⁴

3. KEY ISSUES: CHINA CHALLENGES THE GENERAL PRINCIPLES AND SUBSTANCE OF LIBERAL MULTILATERALISM

In December 2019, Chinese Foreign Minister Wang Yi invited the European Union to “join hands to defend multilateralism and maintain international order.”⁵ A few months later, the High Representative of the European Union, Josep Borrell, lauded the EU's and China's “common language” on this issue,⁶ although he recognized during the Covid-19 crisis

that the “approaches to multilateralism differ.” Given the current trajectory of China’s international behavior, Europeans will come to realize that Beijing is not only non-convergent but a formidable competitor for Europe’s liberal multilateralism.

ISSUE 1 - GENERAL PRINCIPLES: POWER, NOT RULES

At first glance, China seems to be relatively aligned with what most liberal OECD governments preach and often practice in global institutions. Overall, Beijing is largely compliant with the established rules in international institutions to which it has committed. It also presents itself as a “supporter, defender and promoter” of multilateralism and global governance. It is already the second-largest contributor to the UN and now leads four of the 15 UN specialized agencies.

China is, however, increasingly demonstrating its unwillingness to follow rules and obligations that go against its key interests. In the competition for global power, the Chinese leadership will leverage its growing diplomatic capabilities and institutional clout to achieve its strategic priorities. Europe should therefore expect more self-serving and outright disruptive behavior in this arena.

Europe will have to defend the principles that it cherishes

Domestically, the CCP has ensured that it enjoys almost unchecked power, rendering the rule of law and legal institutions secondary functions. Globally, the leadership is also less willing to accept any constraints or higher authority. China’s open and assertive violation of international commitments such as the Sino-British Declaration or the rejection of international verdicts, such as by the UNCLOS arbitration tribunal on South China Sea claims between the Philippines and China in 2016, have become a permanent feature. With critical developments, for instance in Hong Kong, unfolding by the day, Europe will have to defend the principles that it cherishes.

ISSUE 2 - HUMAN RIGHTS AND DEVELOPMENT: SUBSTANCE REVERSED

Conflicts of interests between Europe and China are even easier to detect when it comes to the substance of global multilateralism. In the realms of human rights and sustainable development, for instance, Beijing is pushing the existing international regimes and communities of practice into a modus operandi where the state matters most. The state becomes sole protector of domestic security, the central driving force for development and the ultimate arbiter to grant or take away human rights in line with security and development needs.

The human rights violations in Xinjiang and the undermining of democracy in Hong Kong stand out for their corrosive impact on global multilateral institutions. Beijing justifies its treatment of predominantly Muslim minorities in Xinjiang and securitization of Hong Kong with the need to protect China’s political stability and territorial integrity from terrorism and secession, emphasizing collective rights held by the state over individual rights. Its approach to solving these issues clearly conflicts with its obligations under international human rights law.

Numerous reports support claims that, in Xinjiang, China has deprived large numbers of Uighurs and other ethnic minority members of their liberty, separated families, enforced birth-control and facilitated forced labor. This is particularly serious as it means that China has not only violated its obligations as a party to conventions against racial discrim-

ination (CERD) and torture (CAT), but such wide-spread, systematic violations of basic human rights may even qualify as crimes against humanity.

Measures such as targeted birth control or forcibly transferring children between ethnic groups are prohibited under the Genocide Convention. The introduction of the National Security Law in Hong Kong, too, will likely result in frictions with the International Covenant on Civil and Political Rights (ICCPR) which Hong Kong is party to.

The Chinese party-state is not only resisting pressure for change and independent investigations by UN rapporteurs but increasingly going on the offensive in positively framing and rallying international support for its course of action. On an institutional level, China has used its position in the Human Rights Council and other UN institutions to counter and contain criticism and statements against its practices through a variety of means.⁷ It has also used existing multilateral platforms, such as the Shanghai Cooperation Organization it co-founded in 2001 and the South-South Human Rights Forum it established in 2017, to promote its positions and values.⁸

Beijing presents its governance approach at home as a model for others to learn or borrow from.⁹ In the sphere of development, China promotes its view of political stability and security as a precondition for development and its approach to development as a solution for security challenges.¹⁰ Furthermore, it is putting its money behind this. In 2016, China pledged to contribute 200 million USD to the United Nations over a ten-year period to help establish the United Nations Peace and Development Trust Fund (UNPDF), with a special focus on Africa.¹¹ This is accompanied by Chinese-led multilateral platforms such as the China-Africa Peace and Security Forum, which was held for the first time in 2019 as part of a broader push to link peace and security issues in China-Africa diplomacy.¹²

Most prominently, China has been successful in promoting its bilateral diplomacy via the Belt & Road Initiative (BRI) as a quasi-multilateral arrangement, framing it as the leading global development initiative. In early 2020, 138 countries were counted as part of the BRI, the vast majority of which were developing countries. With this initiative, China is clearly filling a demand for access to funds and infrastructure, often providing recipients with a sense of choice and agency while also contributing to the achievement of global Sustainable Development Goals (SDG).

China has been successful in promoting its bilateral diplomacy via the Belt & Road Initiative

The BRI, however, in many ways exemplifies China's divergence from OECD principles. By objective and composition, China's development finance in the framework of the BRI and beyond differs fundamentally from Western approaches. Beijing does not report its expenditures to the OECD Development Assistance Committee (DAC), and BRI development financing comes with far fewer strings attached in terms of good governance and human rights standards.

Despite these divergences, development policy remains a space that offers opportunities for cooperation. China has in recent years been confronted with criticism over the financial, social and environmental sustainability of its investments and projects. Beijing has responded with an internal reflection and institutional adaptation process. This provides new opportunities for multilateral cooperation. The new Multilateral Cooperation Center for Development Finance (MCDF), that was initially to be established at the World Bank and is now situated at the AIIB, could be a testing ground.

However, the real test for China's sustainable development practices is just around the corner: It is unclear whether Beijing will align with European and other G-20 partners in "building back better" (i.e., greener) post Covid-19. It also remains to be seen to what extent it can and will continue to provide debt relief for those affected by the pandemic and the global economic fallout.¹³

ISSUE 3 - TRADE AND INTERNET GOVERNANCE: NEGOTIATING NEW AND REVISING EXISTING RULES

Beijing is unlikely to agree to new rules that would tame state-interference

There are two major – partly intersecting – areas of global multilateralism where the world and Europe urgently require new and better rules: global trade and the digital space. On trade, Europe and China are formally engaged in discussing WTO reforms – albeit with hardly any signs of progress. For the foreseeable future, Beijing is unlikely to agree to new rules that would tame state-interference, neutralize subsidies, protect IP rights and strengthen transparency and reciprocity. On the contrary, with its own ambitious trade policies it is seeking to compete as a standard- and rule-setter across the world, including in key regions where the EU wants to make its mark.¹⁴

The same is true for the digital space, where China is very explicit about its ambitions to craft new norms itself, ranging from digital trade to data security, IoT, blockchain and the future architecture of the internet. On global internet governance, specifically, the PRC presents itself as a champion for the interests of the "majority of countries." This approach, personally endorsed by Xi Jinping, should be read as a rallying call against Western dominance over the design and governance of the internet.

Although official Chinese rhetoric is no longer openly hostile to the multi-stakeholder model of internet governance, it prioritizes cyber sovereignty and an approach focused on the right of national governments to determine features of cyberspace within their jurisdiction, sidelining civil society or private corporations in negotiations. China also supports technical proposals in standard-setting forums such as the International Telecommunications Union that could facilitate increased state control over internet infrastructure globally. China's 2017 *International Strategy for Cooperation on Cyberspace* calls expressly for the UN Internet Governance Forum (IGF) to play a greater role in global internet governance, and commits Beijing to promoting reform of ICANN, the US-based NGO that oversees the internet's global domain name system.

A crucial cross-cutting area of incompatibility between China and the EU is the different standards and priorities when it comes to securing data and information flows. While the EU places a focus on strong privacy protections for personal data and is intent on securing this in multilateral agreements, China is promoting its vision of state-centered cyber sovereignty and is more concerned with securing access to information and personal data for the purpose of ensuring political security. This will continue to hinder meaningful transnational agreements aimed at facilitating cross-border transfer of data and services.¹⁵

4. EU-CHINA RELATIONS: EUROPE'S RELATIVE POWER DEPENDS ON EFFECTIVE COALITIONS

“We have our own letters” Josep Borrell, HRVP, responded to the question why Europe was not joining like-minded partners to coordinate policies on Hong Kong in July 2020. However, the EU cannot promote the norms and principles associated with liberal multilateralism alone, much less shape China's trajectory on any of these issues.

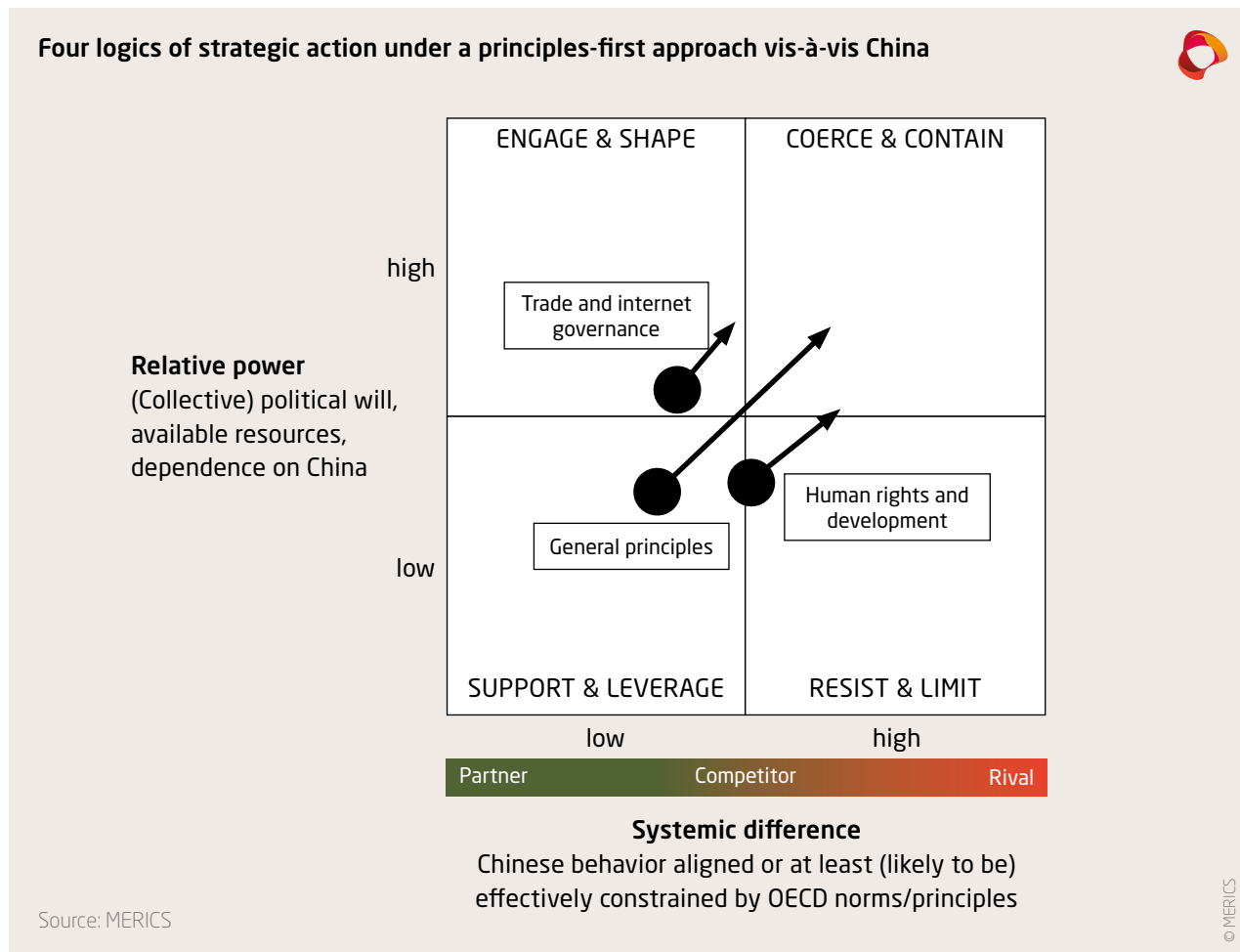
As the EU has stated in its “Strategic Outlook” on EU-China relations, it is committed to engaging with China to uphold the rules-based international order, including all three pillars of the UN: human rights, peace and security and development. With China winning the numbers game, such engagement will become more difficult. The influence of liberal economies with democratic political systems at the UN or in the WTO is shrinking rapidly. When 22 liberal democracies sent a joint open letter expressing concern over internment camps in Xinjiang to UN Human rights authorities in 2019, this was followed by a letter with 50 signatories lauding China's approach and achievements in “protecting and promoting human rights through development.”¹⁶

The influence of liberal economies with democratic political systems at the UN is shrinking rapidly

Building on the legal and institutional foundations of liberal multilateralism, Europe can, however, still exert significant influence – if it chooses to. The UN and the WTO provide an important platform to address specific behaviors. Successful pushback led by Five Eyes states and India, for instance, against the use of the phrase “shared vision of a common future” in the declaration marking the 75th anniversary of the UN, points to the continued relevance of coordination with old and new partners.¹⁷

On trade and digital issues, the EU can at least be peer competitor if not global leader in setting rules and standards. The GDPR's global impact and Europe's comparatively successful global trade strategy are examples of its continued normative power. Cooperation with like-minded partners such as Japan, aligning with the United States on select issues and, ultimately, building a global network of partners could tilt the balance towards OECD interests and help preserve competitive liberalism in trade and digital affairs. As Chinese tech firms come increasingly under pressure for data privacy and national security concerns – a direct outcome of China's domestic laws and regulations – partial cooperation with the EU may well become more attractive for China.

Exhibit 9



5. POLICY PRIORITIES: COMPETING FOR THE FUTURE OF LIBERAL MULTILATERALISM

To promote liberal multilateralism globally, the overarching logic of European responses and initiatives vis-à-vis China has to be significantly more competitive, accepting the systemic rivalry that China’s leaders take for granted. If Borrell wants Europe to start speaking the language of power, here is a field to begin with. Many of the specific actions by Europe in the coming months and years will have to aim at containing and limiting the effects of the Chinese party-state’s illiberal policies. One of the biggest constraints on China’s international behavior will continue to be that Beijing wants to be seen as a trustworthy, reliable and responsible great power.

With cooperation and conditional engagement on specific issues, such as shaping the rules on trade, digital and development, there is plenty of room to act. Europe’s course of action will, however, have to take China’s non-convergence seriously and create the leverage to work around China where working with it proves impossible or even damaging.

This will remain the case for universal human rights as China challenges the concept outright and common ground has shrunk to poverty alleviation and the protection of basic rights to life, health and education. Concrete measures will have to move beyond the failed quiet diplomacy approach of the past towards compelling and resisting. Calling out violations consistently and building new alliances to coordinate responses is not only a basic moral obligation – it is a strategic imperative in competing for the future of multilateralism. The EU and its member states should follow through with political options provided in EU and international law. A recent example is the EU resolution calling for a case to be filed before the International Court of Justice alleging that China’s decision to impose national security legislation on Hong Kong violates the Sino-British Joint Declaration and the International Covenant on Civil and Political Rights (ICCPR).

As a major donor and actor in the development sphere, the EU should make more strategic use of its capacities to engage and shape China’s behavior. The EU will have to better use all available platforms, from traditional multilateral forums in the UN to newer ones such as the UN Peace and Development Trust or the Multilateral Cooperation Center for Development Finance (MCDF) to engage China on its lending practices. Working with partners, the EU should also promote liberal multilateralism bottom-up by building capacities in developing countries to better monitor, evaluate and assess the conditions of investments and support their ability to advocate for their interests.

Most importantly, member states will have to empower the EU to deliver on its own connectivity policies. The EU’s connectivity strategy has built-in European principles and norms that in many ways provide an answer to key challenges associated with the BRI. But only a financially bolstered approach can have real impact on environmental, social and financial sustainability in Eurasia and Europe’s neighborhood. The current European approach also lacks recognizable branding and could benefit from synergies with initiatives with like-minded partners, such as the United States’ Blue Dot Network and Japan’s new connectivity strategy.

In terms of updating global rules for trade, Beijing’s current trade policy profile does not make it a natural partner for the EU. Given limited prospects for success and diminishing relative power, the shift to a resist and limit logic is warranted. This will entail focusing on targeted adjustments that can protect the European market economy system and mitigate the damage of China’s distortionary behaviors. European actors should double down on working with like-minded partners on introducing new rules and disciplines on subsidies, IPR protection and the treatment of state-owned enterprises (SOEs). With the ongoing WTO crisis further reducing the EU’s power, effective rulemaking in light of China’s trajectory will therefore to a large extent depend on making the transatlantic relationship functional again.

In terms of updating global rules for trade, Beijing is not a natural partner for the EU

In the digital arena there are still limited opportunities to engage and shape China’s approaches to improve data security and facilitate cross-border data flows. But the EU should also engage more proactively with key partners such as India and the US as well as stakeholders in critical third regions on data privacy and security frameworks to set global standards. The EU should resist and limit – as much as possible – the global fragmentation and nationalization of the digital world. In global internet governance, Europe needs to level-up its support for the multi-stakeholder model at the global level (such as the Internet Governance Forum) with a focus on values and innovation.

In adjusting their policy responses across these fields, European decision-makers should be guided by two considerations. First, China's selective adherence to essential international obligations puts into question Beijing's trustworthiness as a partner more broadly. Second, the issues outlined above constitute an integral and interlocking system of liberal multilateralism. Non-action or silence on one of them will damage Europe's long-term capacity to compete and deliver in adjacent arenas.

5. Delivering Global Public Goods

Nis Grünberg and Thomas des Garets Geddes

KEY FINDINGS

- The Covid-19 pandemic and the global climate crisis have put the spotlight on the need for global cooperation, with issues around China front and center.
- It is by no means a given that China will be “building back greener” after the crisis. Beijing is under massive pressure to restart the economy and commitments to climate and energy reforms are already taking a backseat.
- On climate, the EU will have to step up its game and engage China more forcefully to shape its behavior.
- The EU needs to make its support for Chinese initiatives like the AIIB and BRI conditional on binding commitments to the climate (and financial) sustainability of projects.
- On global health, the EU will find itself in a position of supporting and leveraging. Yet on China’s heavy-handed efforts to gain support for its Covid-19 response model, the EU should adopt a decisive resist and limit response.
- On the other hand, the EU should continue to actively engage and cooperate with China on targeted global health projects and research.

1. CRISIS LESSONS: POWER POLITICS AND CONTESTED RESPONSIBILITIES THREATEN GLOBAL SOLUTIONS

The Covid-19 pandemic and the global climate crisis have not only had a dramatic impact on millions of lives across the globe, they have also put the spotlight on critical national responsibilities and the need for global cooperation, with issues around China front and center in a way that matters fundamentally to Europe.

During the first months of the crisis, China’s role in delivering effective solutions was heavily contested on multiple fronts. Beijing’s role in the World Health Organization (WHO) was the main reason put forward by Washington pulling out of the organization. The supply of PPE from China split the world into grateful recipients and critics doubtful of its motives. In Europe, Beijing’s mask diplomacy and associated disinformation has, overall, damaged China’s image. And when the EU organized a global pledging conference in May 2020, both the US and China were missing in action.

For a short period, at the beginning of the pandemic, levels of air pollution in China and elsewhere dropped significantly, but going forward, climate cooperation might become another victim of the crisis. It is, for instance, by no means a given that China will be “building back greener”; quite the contrary – under massive pressure to restart the country’s economy, Beijing’s commitments to climate and energy reforms are already taking a backseat.

The corona crisis is a strong reminder that the provision of Global Public Goods (GPGs), including on global health and climate, constitutes another arena in which great powers not only have to prove themselves. They also have to prove they can work together effectively with others, despite political differences. The EU, for example, has committed to delivering GPGs as “integrated rather than fragmented solutions” for global problems.¹

To address such global challenges and shape global cooperation in accord with OECD principles and European interests, getting to grips with China is and will be central. The EU will increasingly find that China is ambitious in its own efforts to shape the provision of GPGs. As the largest emitter of CO₂, Beijing needs to take on bigger responsibilities in global climate action. On questions of global health and climate, cooperation with China will, however, be hampered and frustrating given growing distrust in other arenas, shifting domestic priorities, global power politics and political differences.

Recognizing these constraints, the EU will have to pursue a two-pronged strategy vis-à-vis China on climate and global health: doubling-down on conditional cooperation to engage China and shape its behavior while competing in actually delivering these GPGs to create pressure for upward convergence.

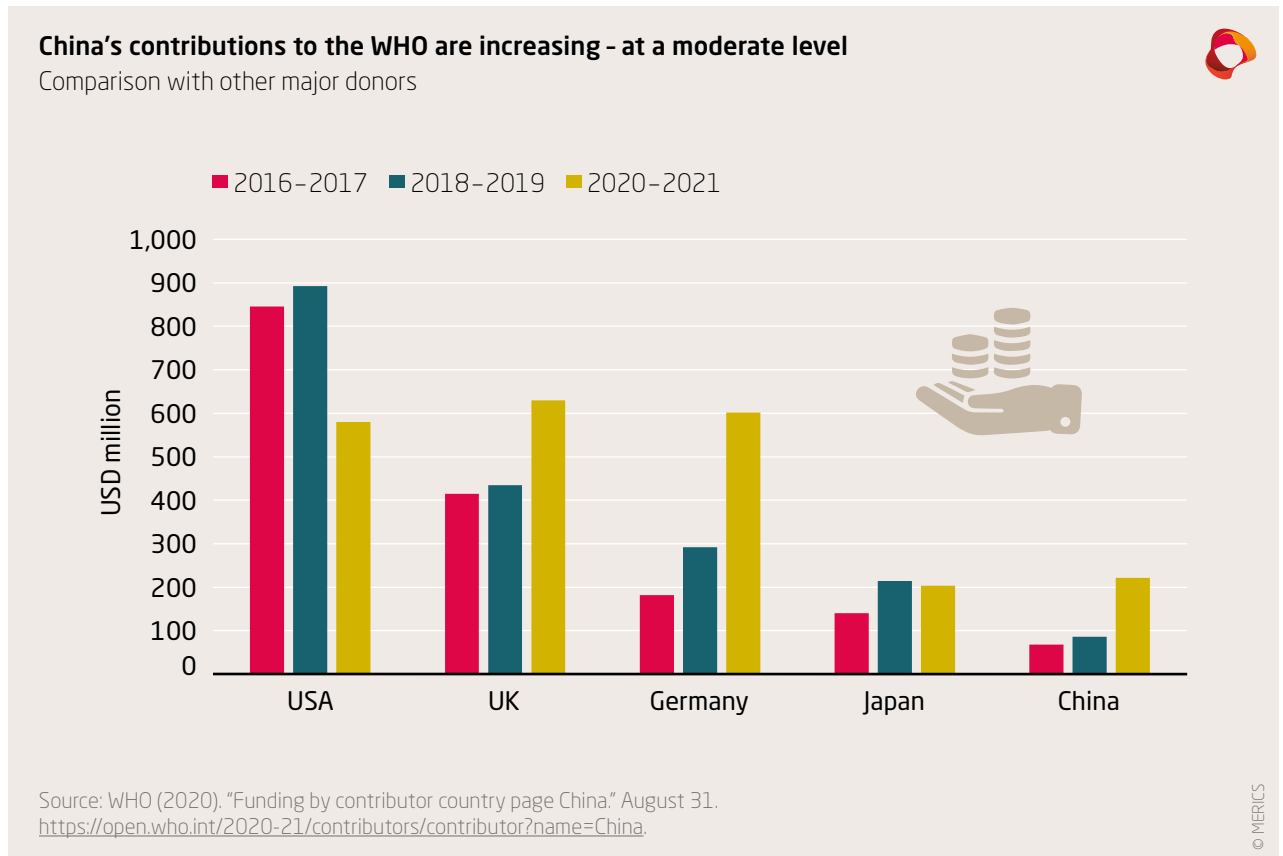
2. TRAJECTORY: CHINA ACTS ON DOMESTIC PRIORITIES, GLOBAL EXPECTATIONS AND BRANDING OPPORTUNITIES

China is still a relative newcomer to the provision of GPGs. Up until just a decade ago, it was rare to hear Chinese leaders discuss or promote China as a global GPG player. Yet in recent years China has shifted from cautious defensive behavior into a much more proactive role. Today, Beijing claims to be a displaying climate leader and is keen to promote and protect Chinese interests in climate negotiations. It has ramped up its role in the WHO and branded its “Health Silk Road” as an example of its participation in cooperative global responses to the crisis.² There are three main drivers of this growing involvement in GPGs: **(1)** pressing domestic problems, **(2)** foreign pressure and expectations and **(3)** opportunities to shape (perceptions of) China’s global role.

In the last decade, China has ramped up environmental regulation

The first driver behind China’s growing role in participating in the provision of GPGs is China’s own domestic challenges. Climate change for example, is recognized by Beijing as a “huge challenge to the survival and development of the human race.”³ In the last decade, China has focused on moving away from fossil fuel, and ramped up environmental regulation. China has also become much more willing to participate in global climate and energy discussions, tapping into broader global discussions and networks on climate solutions, including advanced green tech useful for China’s domestic development. Lastly, domestic climate action is claimed to be a contribution to GPGs, as well as to ‘greenwash’ party rule.

The second driver of China’s more active role in GPG provision is pressure and expectations from other countries. In particular, China has responded to changes in US GPG policy and behavior. Calls for China to be a more “responsible stakeholder” have had an impact: it is increasingly willing to adopt the language of “responsibility” and “global public goods” in its foreign policy,⁴ and its commitments as well as the cooperation with the US required for the Paris climate agreement signaled the possibility of real joint or aligned action in the face of global challenges.



A third and more challenging motivation for China's growing involvement in GPGs is Beijing's disposition to exploit strategic and image opportunities as they emerge. Since 2017 and during this crisis, Chinese leaders have been keen to point to diminished US support for global climate solutions and global health institutions, and to contrast this with Beijing's own supposedly responsible role.

However, China's narrative about GPG provision often takes awkward turns. On development issues and the BRI, China claims that its own unilateral policies and initiatives are already a type of GPG, and every Chinese overseas infrastructure loan is sold accordingly as a GPG contribution. During the corona crisis, China's state propaganda went into overdrive to promote China's image as a "responsible great power" (负责任大国),⁵ which made the discrepancies between these branding efforts and actual behavior even harder to reconcile for most western international onlookers.

Taken together, these three drivers put China on a challenging trajectory for Europe. While systemic differences should not matter that much, the crisis has shown that a lack of trust and transparency and putting propaganda over substance creates massive hurdles for actual cooperation in GPG provision. While both sides might align on the analysis and increasingly on ambitions, specific interests and priorities will diverge in practice.

3. KEY ISSUES: BALANCING COOPERATION AND COMPETITION IN GLOBAL PUBLIC GOODS DELIVERY

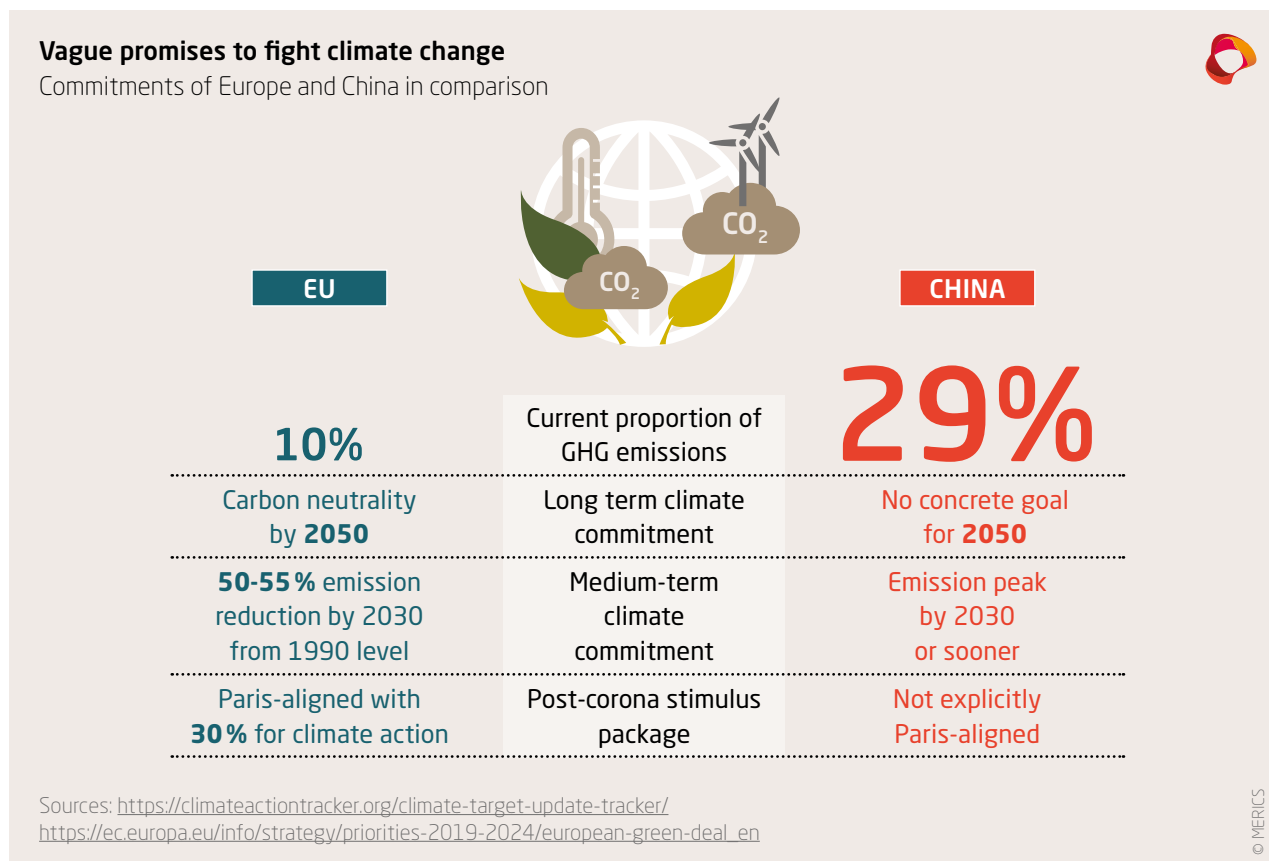
In the area of GPG provision, the EU has clearly stated positions and aspirations. It targets five key issue areas as matters of priority: environment, health, knowledge, peace and security and governance. While the first two of these are broadly aligned with Chinese priorities, they also differ significantly in the detail. Moreover, EU emphasis on good governance as a GPG, which rests on support for liberal political and economic institutions and processes, is almost certainly at odds with China’s own GPG aspirations.

ISSUE 1 - CLIMATE NEGOTIATIONS: OLD WINE IN NEW BOTTLES

On climate, Europe will rightly seek cooperation with China in two specific areas: climate negotiations and the promotion of a “green” BRI. On the Paris Agreement targets, China has moved from being a skeptical participant to the UN climate talks in 1992, to one of the most active voices. And under Xi Jinping, China has made much of its aims to promote “ecological civilization” at home and abroad.⁶ Even in the midst of the corona crisis, China, at the national level, has banned coal-related projects from receiving green finance, boosted clean electricity targets and pushed regional power sector consolidation to reduce coal power overcapacity.

Yet such ambitions belie challenges and contradictions. China seems unlikely to move away quickly from coal power generation. In the first six months of 2020, China approved coal-fired powerplants with a total capacity of 48 GW for construction.⁷ And despite decommissioning old plants and consolidating regional power companies, eight months into 2020, coal power capacity has seen a net increase of 20 GW. The country’s response to

Exhibit 11



the corona crisis will emphasize economic recovery and therefore downplay clean energy targets and environmental concerns. Efforts to forge a “green recovery” and implement an emissions trading system are likely to disappoint as they take a backseat to employment-generating policies, including in heavy industries.

Efforts to forge a “green recovery” are likely to disappoint

ISSUE 2 - GREEN BRI: UNDER FINANCIAL PRESSURE

A “green BRI” is China’s official effort to promote its overseas infrastructure agenda as environmentally friendly. Especially since 2017, China has made a series of high-profile statements about the BRI, claiming it is part of a broader commitment to mitigating climate change and to promoting cleaner sources of energy.

Yet the green BRI agenda, too, is beset with contradictions. Well over half of BRI investments and financing have been devoted to energy projects, but many of those have been for polluting coal-fired power plants. In addition, Chinese firms have increasingly invested in or financed energy grid projects, many of which themselves transmit energy from fossil fuel sources. Given the economic impact of the corona crisis, China’s commitment to a more climate friendly BRI will therefore run up against the challenges of limited budgets, especially in poor and emerging markets.

ISSUE 3 - GLOBAL HEALTH REGIMES: A NEW BRI PLAYING FIELD

On global health, China used to keep a relatively low profile within the WHO, especially after it was criticized for covering up the 2003 SARS outbreak. Since 2017, however, China’s role has expanded, with financial contributions to the WHO having more than tripled to around 221 million USD for the 2020 – 2021 budgetary window.⁸ Controversies have arisen around China’s role in the WHO’s response to Covid-19 because of the way it stifled criticism about its own initially slow and opaque response to the virus’s outbreak in Wuhan. Its continued intransigence toward granting Taiwan observer status in the WHO’s World Health Assembly has further underscored worries that China’s political interests and values are at odds with the organization’s core global health mission.

In addition, China has used the pandemic to revitalize a little-known offshoot of the BRI, the Health Silk Road (HSR), as part of its contribution to global health solutions. First announced in 2015, the HSR built on the BRI framework to promote various Chinese health cooperation efforts, including for pandemic preparedness, aimed at improving public health in developing country regions, especially in Southeast Asia. China had long developed a global footprint in building hospitals and partnerships for medical knowledge transfer. However, with the outbreak of Covid-19, China emphasized its “mask diplomacy” and digital health applications as being also part of this initiative.⁹ The HSR and affiliated projects have received support within the WHO, an example of how China’s role in international health organizations can bolster its broader global health ambitions.

4. EU-CHINA RELATIONS: EUROPE IS IN THE LEAD, BUT GETTING CHINA ON BOARD REMAINS THE ULTIMATE TEST

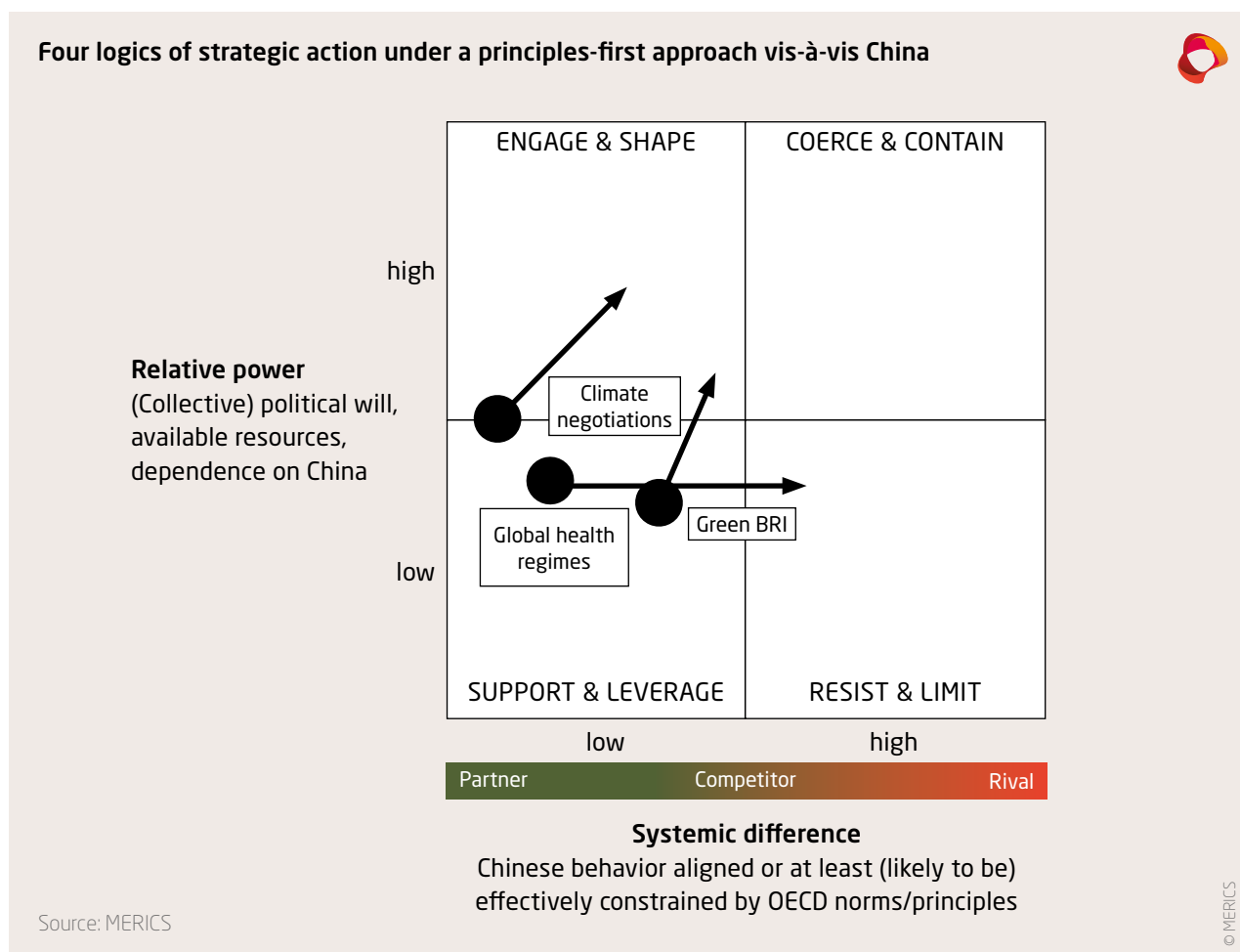
The EU comes to GPG provision with much longer experience in OECD cooperation and is a leader on many of the standards, norms and multilateral institutions that are at its heart. The EU therefore has significant strengths when it comes to setting the GPG agenda even if the actual joint provision of GPGs remains difficult.

On climate as a GPG, the EU is one of the most important and influential actors. However, while sharing many overarching climate cooperation goals with China, the EU is limited in its leverage because of international and domestic Chinese realities. Without US pressure and participation in delivering on Paris commitments and broader climate change cooperation, China is more easily able to tone down more ambitious targets formulated in its Nationally Determined Contributions (NDC) of the Paris agreement.

On China’s promotion of a “green BRI,” the EU also faces contradictory Chinese behavior and has limited tools to leverage changes on China’s side. Even in the area of possible cooperation on climate-friendly energy, China’s procurement and subsidy policies make European participation in greener BRI projects difficult. The EU’s connectivity strategy has potential as a policy instrument to engage with China or provide support for EU firms to move toward more “sustainable” energy and other infrastructure development. However, the EU has yet to fund or move forward with this.

In the arena of global health, EU member states and Brussels are significant players. Germany and France (and, in the past, the UK) have laid out and acted on ambitious strategies with a global horizon. Excluding what EU member states give individually, EU institutions spent 1.2 billion USD on official development assistance to health in 2016, a large share of which was earmarked for multilateral institutions, including the WHO. In response to Covid-19, in contrast to China’s approach, the European Commission has pushed for a multilateral effort and helped raise 7.4 billion EUR at a donor conference in May for the development and distribution of vaccines against the virus.¹⁰ Moreover,

Exhibit 12



through its own medical and pharmaceutical industries and research, EU countries are important providers of medical equipment and life-saving drugs.

5. POLICY PRIORITIES: CONTINGENT ENGAGEMENT ON CLIMATE CHANGE AND GLOBAL HEALTH

There is broad overlap in EU and Chinese interest to support the provision of GPGs in general. This stands in unfortunate contrast to policies of the current US administration which, under President Trump, is retreating from decades of leadership in this arena. The EU will want China to move in directions that progressive forces in its system, such as doctors, scientists and environmentalists, have said it should move towards. This will often mean holding China to such commitments through a mixture of incentives and disincentives.

On climate, the EU will have to step up its own game

On climate, the EU will have to step up its own game and engage China more forcefully to shape its behavior. As the United States remains a key factor, pushing China to become greener will require deeper EU-US cooperation on climate in whatever way possible. Where China and the EU have existing partnerships and cooperation (e.g. the Paris agreement and EU-China strategic cooperation), the EU must double down and hold China to its own words. The EU must be better at “doing its homework” on China's domestic policies so that it can hold China accountable, for instance on its lofty “ecological civilization” ambitions. China's 14th Five-year plan, setting out its national goals for 2021 – 2025, is probably the world's most consequential policy framework affecting global efforts to tackle climate change.

EU engagement with China on trade, science and technology cooperation, investment and finance should also be made contingent on climate change discussions and policy. This will be challenging on both sides, and if the EU wants to build leverage on this matter, it must also enact stricter and more ambitious policies at home.

Only by leading by example can Europe sell its green ambitions abroad, including to China. The coming months offer a small window of opportunity for a more ambitious Europe-China climate partnership. To get there, NDC discussions should be prioritized, especially with regard to the long-term strategy for 2050 net zero. While the EU has committed to zero carbon by 2050, China has not stated any concrete long-term commitments. In order to achieve the Paris agreement's targets, however, China must accelerate investment in zero-carbon electrification, also with the help of European technologies.

The EU should also make its support for both the AIIB and BRI directly conditional on binding commitments to the climate (and financial) sustainability of financed projects, with the goal of phasing out fossil and coal investments. The EU should enlist global partners for bolder standards regarding international energy projects and green finance. The connectivity strategy and its commitments to “sustainable” connectivity remains the single best framework for pushing China toward higher standards and supporting EU firms that abide by these, too.

On global health, the EU will likewise find itself in a position of supporting and leveraging, but also moving toward engaging and shaping China's behavior. Yet on China's “mask diplomacy” or its heavy-handed efforts to gain support for China's Covid-19 response model, including through the WHO, the EU should adopt a more decisive resist and limit response.

With the United States' declining influence in the WHO, it is EU member states that, together, should fill the void. They must act as a counterweight to Beijing when it attempts to re-shape the rules, norms and values that underlie global health governance institutions. The EU and its allies must ensure that the WHO remains an independent and objective organization — capable of asserting its authority and refusing political interference during international health crises. EU member states should therefore use their financial and diplomatic weight to push through much needed reforms within the UN agency. In particular, the EU should promote reform of the WHO's funding system, emergency management mechanisms and independent post-epidemic investigations. The EU should also aim to help Taiwan obtain observer status at the World Health Assembly.

China's Health Silk Road presents the EU with multiple new policy challenges. On the one hand, the EU should unite with like-minded countries to push back against Beijing's corona propaganda and disinformation campaigns. On the other hand, the EU should continue to actively engage and cooperate with China on targeted global health projects and research. When China makes widely publicized financial pledges towards global health, the EU should ensure that Beijing delivers on these promises and should call it out when it does not. In general, the EU should demand much more transparency when it comes to China's bilateral health programs and encourage Beijing to funnel a greater share of its development assistance for health through multilateral organizations.

6. Engaging in effective geopolitical competition

Helena Legarda

KEY FINDINGS

- In the shadow of the coronavirus pandemic, China has expanded its geopolitical clout in old and new geographies and domains. In the years ahead, Europe will increasingly be forced to resist and limit China's geopolitical power projection.
- Two decades of substantial economic growth, along with a major campaign to modernize the armed forces, have significantly increased China's power projection abilities, and the CCP has detected a growing number of pockets of vanishing Western influence in the international system.
- Recent years have seen a considerable uptick in China's deployment of investments and lending to expand its footprint in the Western Balkans, and Beijing's involvement in the MENA region is rapidly evolving.
- Beijing organizes growing numbers of military drills and maneuvers in the Indo-Pacific, meant both as a show of force and an implied threat to neighbors.
- China is also increasingly moving into new spaces and domains of geopolitical competition, like the Arctic, which is also of considerable geostrategic interest to the EU.
- Although Europe's relative power vis-à-vis China is limited in many areas, it does not mean that the EU has no leverage or tools to use when confronting China's geopolitical ambitions.

1. CRISIS LESSONS: CHINA EMERGES AS A GEOPOLITICAL RIVAL TO EUROPE

In the shadow of the coronavirus pandemic, China has expanded its geopolitical clout in old and new geographies and domains. Beijing stepped up its military presence in the South China Sea and the Taiwan Strait and did not shy away from a confrontation with India at the disputed joint border in Ladakh. China also managed to present itself as a critical provider of Covid-related aid in the Western Balkans and completed work on its Beidou satellite system, expanding its ability to project force in space.

The pandemic has provided Beijing with an opportunity to further expose and exploit vulnerabilities in the already strained Western-dominated global order, taking advantage of the distraction of other countries. It has left onlookers in Europe in no doubt that China will be a force to be reckoned with in the future in virtually all aspects of geopolitical competition – whether in political, economic or military terms.

In becoming a geopolitical actor on the global stage, China will more often than not be in conflict with the norms, principles and interests of OECD countries. For example, China uses investments and lending on the EU's doorstep in the Western Balkans to influence the strategic orientation and policy choices of the countries in the region, as Serbia's rapprochement with China illustrates. China uses a wide range of political and security policy tools, such as defense diplomacy, arms exports and even military deployments, to increase its footprint in the MENA region.

By doing so, China is increasingly prepared to clash openly with EU and US interests, for example in Syria. And in what is perhaps the clearest example of geopolitical competition with OECD and European partner countries, China also uses its growing military power projection abilities in the Indo-Pacific to contest the presence and influence of liberal democracies in the region. On top of this, a new area of geopolitical contestation between China and the West is already emerging in the Arctic.

The logic of member states' engagement with China still has all too often neglected the geopolitical dimension

Despite the EU's recent heavy emphasis on becoming a more geopolitical actor and its recognition of China as a "systemic rival,"¹ the logic of member states' engagement with China still has all too often neglected the geopolitical dimension. Maintaining strong economic and commercial relations with China has remained a priority of many European capitals, as decision-makers still hoped that such engagement would eventually lead to China's (partial) convergence with OECD norms and principles. It took an unexpected event like the Covid-19 pandemic and China's highly problematic behavior during this crisis, coupled with China's authoritarian drift under Xi Jinping and its standoff with the United States, for Europe to finally start considering the implications of geopolitical competition with China.

While limited areas of cooperation with China still exist and more might emerge, in the years ahead Europe will increasingly be forced to resist and limit China's geopolitical power projection in geographies and domains where the EU has relatively little clout itself and to contain these activities where Europe has power or can establish it relatively swiftly. To this end, the EU and its member states will have to integrate their China policy much more explicitly with wider geopolitical considerations and relevant tools in their geopolitical toolbox.

2. CHINA'S TRAJECTORY: BEIJING'S GEOPOLITICAL INTERESTS WILL HARDLY ALIGN WITH THOSE OF OECD COUNTRIES

Since Xi Jinping came to power, China has gradually abandoned his predecessor Deng Xiaoping's maxim of "bide your time, hide your brightness," leaving behind a period when Beijing chose to keep a low profile in international affairs. China's struggle for "national rejuvenation," which Xi proclaimed first in 2012,² is also one for reclaiming its former status of a truly global power by 2049 – the 100th anniversary of the foundation of the PRC. China's new, assertive geopolitics is driven by two primary convictions.

First, the CCP now feels confident enough in China's strengths and capabilities – political, economic and military – and its own political and economic model. Two decades of substantial economic growth, along with a major campaign to modernize its armed forces, have significantly increased China's power projection abilities. Due to the nature of its one-party system, Beijing is also uniquely able to mobilize and synchronize the activities of all of government, industry and the military, leveraging economic, security and foreign policy tools abroad in an integrated way that liberal democracies cannot easily replicate.

Second, the CCP has also detected a growing number of pockets of vanishing Western influence in the international system that it feels China can and should fill as a basis for cementing its global leadership ambitions. This alleged "period of strategic opportunity" of declining Western influence on the international stage is not a new concept, as it was first articulated by President Jiang Zemin at the 16th Party Congress in 2002.³ However, the

notion has gained significant traction among CCP elites in recent years, especially since the financial crisis of 2008 and even more so with the election of Donald Trump and his administration's retreat from a number of international commitments. The rifts in EU unity that have become more visible since the 2015 refugee crisis and Brexit have also contributed to Chinese assertions that the West is in decline.

The Covid-19 pandemic is seen by Beijing as an opportunity to gain influence in more remote geographies, as other countries remain distracted by their own outbreaks and their economic impact. Given China's clearly laid out intentions and its perception of a window of opportunity, it should come as no surprise that Beijing is increasingly engaging in geopolitical competition with the United States and Europe. It builds partnerships around the globe and popularizes its own political and economic model, while also trying to take the lead in non-traditional areas of geopolitical competition, like space or cyberspace. This trend, which is likely to continue and speed up in the run-up to 2049, will more often than not put China at odds with OECD countries.

In many instances, the “new type of international relations,”⁴ which Beijing is keen on promoting through a more assertive approach to geopolitics and which would see China lead the “reform” of the global governance system, poses a direct challenge to the type of liberalism and multilateralism the vast majority of OECD countries are committed to. While China tries to present itself as a responsible power invested in defending the global order, its actions say otherwise. For example, Beijing has a track record of – directly or indirectly – supporting regimes that the EU and other OECD countries oppose, such as Bashar al-Assad's regime in Syria.⁵ China's growing military power projection is a cause of instability in the Indo-Pacific region, one of the core arenas of geopolitical competition and a lifeline for OECD economies' global supply chains and exports.

China tries to present itself as a responsible power invested in defending the global order, its actions say otherwise

At the same time, areas where European and Chinese interests might selectively converge and where cooperation is possible, such as joint peace missions on the African continent in recent years, seem to be shrinking.

3. KEY ISSUES: CHINA POSES CHALLENGES TO EUROPE IN THE WESTERN BALKANS, THE MENA REGION, THE INDO-PACIFIC AND INCREASINGLY THE ARCTIC

In the coming years, China will pose the greatest geopolitical challenge to the EU in its neighboring regions, specifically, specifically the Western Balkans, the MENA region and the newly emerging geopolitical playing field of the Arctic. However, the EU would be ill-advised to only consider geopolitical competition with China in its neighborhood, as Chinese activities are also putting in question freedom of navigation in the Indo-Pacific.

ISSUE 1 - WESTERN BALKANS AND THE MENA REGION: A NEW PLAYER

Recent years have seen a considerable uptick in China's deployment of investments and lending – often channeled through BRI infrastructure projects – to expand its footprint in the Western Balkans.⁶ China has a vested interest in improving and promoting infrastructure in this underdeveloped region, as the road into the big markets of Western Europe from the Chinese-owned port of Piraeus runs through the Balkans.

China's perceived "no strings attached" approach to investment, along with parts of its authoritarian governance model, have proven appealing to some countries in the region, like Serbia, while the considerable size of some Chinese loans is threatening to drive others, like Montenegro,⁷ into a relation of debt dependency with China. This could make these countries more vulnerable to Beijing's political influence. Moreover, Chinese investments in the EU's neighboring regions often do not live up to the norms and standards promoted by the EU and sometimes even help perpetuate corruption in the region. The Budapest-Belgrade railway project is a case in point, with the EU having opened an investigation into the Hungarian government in 2016 for initially not following EU procurement rules.⁸

Beijing's involvement in the MENA region is increasing rapidly

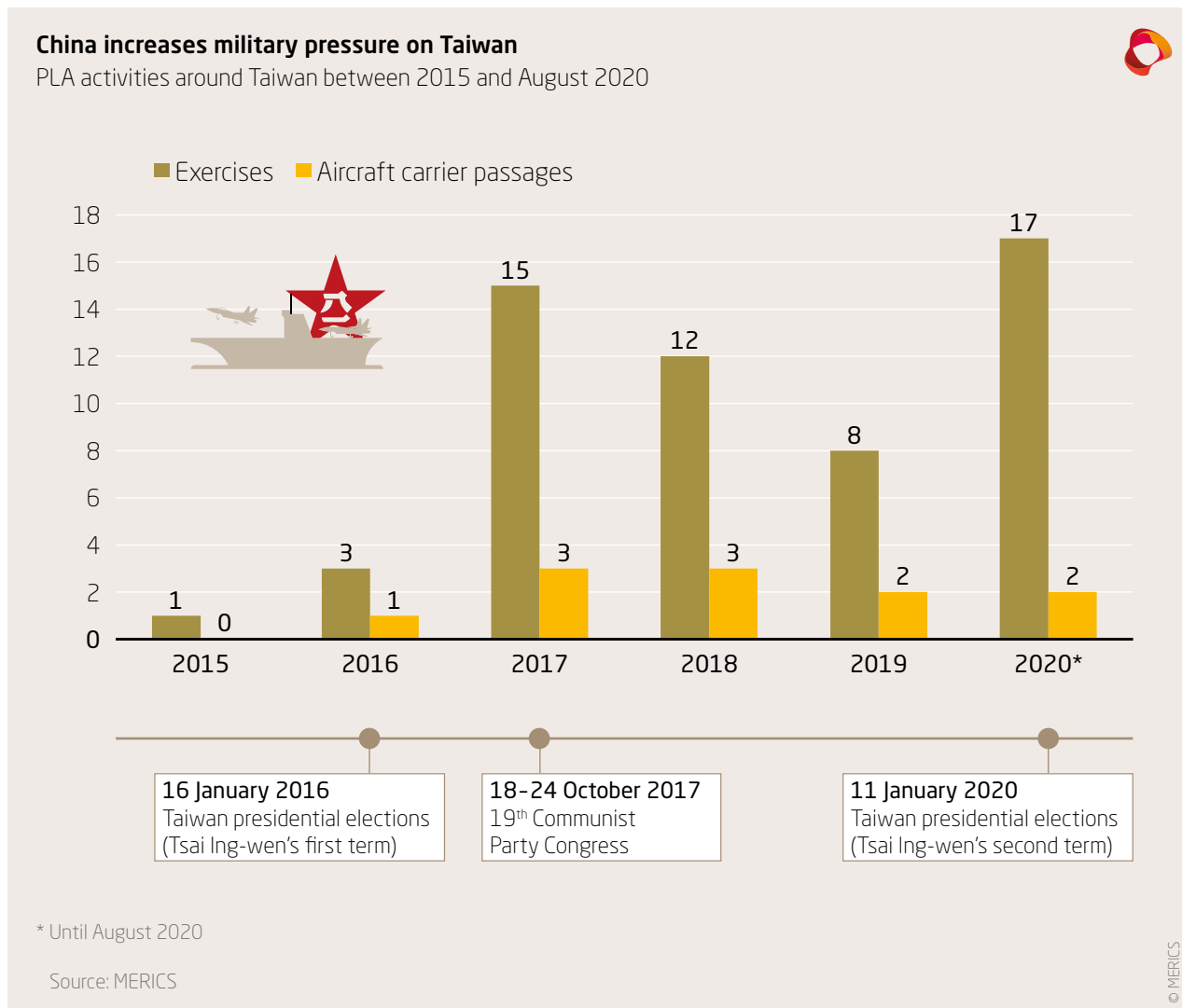
Beijing has traditionally had little involvement in the MENA region, but that is changing rapidly. China needs a stable MENA region if it wants to achieve its goals of expanding the BRI and its access to the region's resources, protecting Chinese citizens and assets and dealing with terrorist threats originating in the region. The Chinese leadership is also using this growing presence to present itself as an alternative partner for MENA countries, one that is an honest broker with no hidden agenda for the region, unlike Europe or the US.

Over the last few years, Beijing has increased its defense diplomacy efforts in the region, with high-level defense officials from MENA countries visiting Beijing regularly to discuss security cooperation with China. The PLA Navy (PLAN) has visited the region on multiple occasions, both for friendly port calls and to hold joint drills and exercises with local militaries. The Chinese military also maintains a permanent presence in and close to the region, with Chinese peacekeepers deployed in Lebanon, the PLAN patrolling the waters of the Gulf of Aden and the opening of China's first overseas military base in Djibouti.

Furthermore, China is becoming a major source of weapons and military technology to the region, often providing the weapons that Western countries refuse to sell, such as armed UAVs.⁹ In the past, Beijing has also offered to mediate in some of the region's longest-running and most intractable conflicts, from Syria and Afghanistan to the Israel-Palestine and Saudi Arabia-Iran conflicts.

ISSUE 2 - INDO-PACIFIC: EUROPE CAN NO LONGER LOOK THE OTHER WAY

Further afield from Europe, the Indo-Pacific has become a major arena of geopolitical competition between China and the United States. While Europe has mostly taken a back-seat with regard to developments in the region, this will not be a sustainable course of action going forward. Recent years have seen an increasingly aggressive Beijing organize growing numbers of military drills and maneuvers in the Indo-Pacific, meant both as a show of force and an implied threat to neighbors. Taiwan is a case in point. Beijing has long maintained that it would prefer to reunify with Taiwan through peaceful means, although it has never ruled out the use of force. While in the past threats from Beijing to use force against Taiwan lacked credibility because of US support for Taipei and the limited capabilities of the PLA, today China's rapid military modernization has created a new strategic calculus. According to MERICS data, PLA aircraft conducted flyovers and drills around Taiwan at least 15 times between January and August 2020.¹⁰ And it is not only the PLA Air Force (PLAAF) that has stepped up its presence near Taiwan. The PLAN also regularly conducts drills in waters near Taiwan, and China's newest aircraft carrier, the Shandong, sailed through the sensitive Taiwan Strait in late December 2019.¹¹



Beijing has similarly increased its presence in the South China Sea, building military installations in the disputed Spratly and Paracel Islands, deploying Coast Guard ships – which have been under the direct control of the Central Military Commission since 2018¹² – to escort survey vessels, engaging in naval standoffs with Malaysia and Indonesia and confronting US Navy vessels conducting freedom of navigation operations (FONOPs) in the region.

China's activities in the Indo-Pacific pose three principal challenges to European interests. First, Europe has a vested interest in protecting stability and freedom of navigation in the area, as key global trade routes traverse the South China Sea. Second, the increasing tensions between the United States and China should also be of concern to the EU, as they could result in a NATO ally (and NATO partners in the region) engaging in military action against China. Third, China's activities pose direct challenges to international law and the international multilateral order, which the EU has pledged to uphold.

ISSUE 3 - THE ARCTIC: MAKING THE RULES

China is also increasingly moving into new spaces and domains of geopolitical competition, like the Arctic. This region is also of considerable geostrategic interest to the EU. Calling itself a “near-Arctic state,” China incorporated the Arctic Ocean into the BRI in 2017, underlining its ambitions in the region.¹³ Despite having no claims to sovereignty, Beijing has developed legal positions on key legal and normative issues in the Arctic, aiming to shape debates on issues such as rights to navigation, access to resources and the application of relevant international law, including the United Nations Convention on the Law of the Sea (UNCLOS), from the start. The expansion of China’s transportation and resource exploitation-related interests in the Arctic is likely to bring with it an increase in Chinese military power projection in the area, which might also be enabled by China’s increasingly close military relationship with Russia.

4. EU-CHINA RELATIONS: THE EU MUST LIMIT CHINA’S GEOPOLITICAL DRIVE WHERE NECESSARY

As the EU aspires to greater strategic autonomy and geopolitical clout, China has started to feature more frequently and prominently on Brussels’ agenda. However, long-standing trends and dependencies have meant to date that most member states are still focusing on maintaining close economic and commercial ties with China while skirting the more difficult political and systemic issues – often due to fear of retaliation by China.

Heightened US-China tensions will force Europe to position itself more clearly

Chinese actions in areas of significant geopolitical interest to the EU and heightened tensions between China and the US will force Europe to position itself more clearly. Indeed, as China increasingly engages in geopolitical competition in its bid to become a leading global power by 2049, a growing number of voices argue that Europe needs to push back harder against some of China’s behavior on the global stage if it wants to become and remain a relevant geopolitical actor in this new multipolar world.

Doing so, however, will require a realistic assessment of the EU’s relative power vis-à-vis China when it comes to the most pressing geopolitical challenges. In the Western Balkans, where China uses BRI-linked economic tools to expand its footprint and influence, the EU still enjoys relatively high power when compared to China, although its reputation has been damaged by unfulfilled enlargement promises and a lack of “self-advertisement.” Europe remains the largest investor in the region and accession to the EU is still the ultimate goal of most Western Balkan countries. However, the EU has not invested enough resources in “selling” itself effectively, often being outmaneuvered by China, which has invested less and yet gained substantial political capital with elites in the region. It is high time for the EU to contain some of the most problematic Chinese activities in the Western Balkans, such as building non-sustainable infrastructure or encouraging authoritarian tendencies.

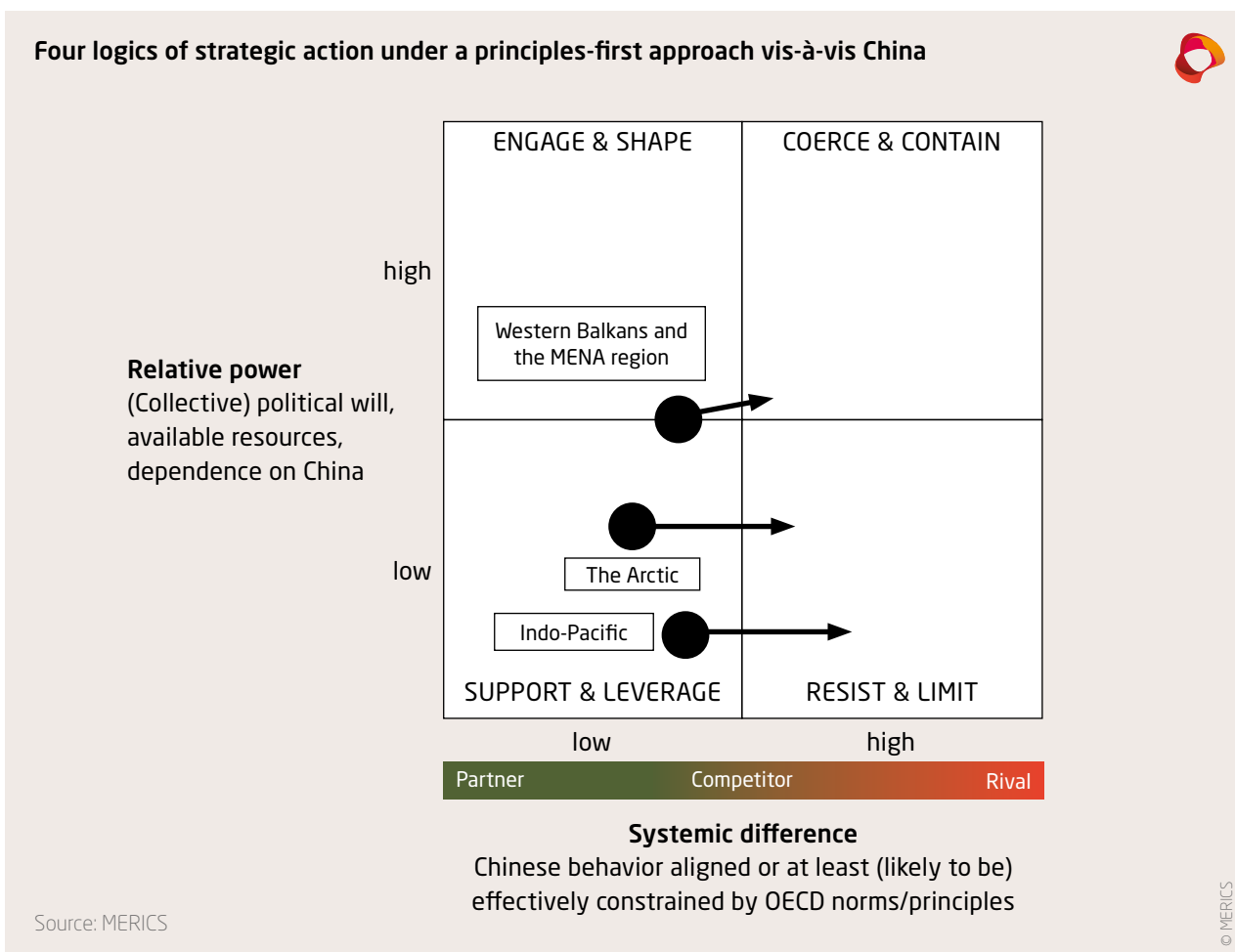
Facing China in the MENA region will require a mixed approach by the EU, as the EU’s power is currently lower. On certain issues, a “support and leverage” strategy would be called for, where European and Chinese interests converge. This is the case, for example, concerning counterpiracy operations or participation in UN peacekeeping operations to maintain stability in the region. Cooperation would also be possible and even desirable when China engages in or promotes development or infrastructure projects in the region that align with European norms and standards and that can help to reduce poverty and inequality in the region.

Beijing’s behavior in other areas, however, would require the EU to resist and limit China’s inroads into the MENA region, as they are detrimental to European interests and ultimately security. Examples include Beijing’s support for authoritarian regimes through exports of restricted weapons systems and surveillance technology and China’s growing power projection in the Mediterranean.

In the Indo-Pacific, the EU’s relative power is low. The EU has no military presence in the region and, since the UK’s exit from the EU, France is the only remaining member state able and willing to deploy its navy to the Indo-Pacific to conduct FONOPs. Besides, tensions in the region remain a low priority for many member states. Therefore, this region calls for a “resist and limit” strategy by the EU.

Three EU member states – Denmark, Sweden and Finland – are Arctic states, and several others are Arctic Council observers, making China’s growing role in the region an issue of relevance for the EU as well. While there are opportunities for cooperation with China in Arctic affairs, there are also clear risks, given the divergence in norms and principles between China and the EU. While Europe’s relative military power vis-à-vis China (and its partner Russia) is low, its geographic position gives Europe the opportunity to push back against China’s attempts to shape the norms and standards that will govern behavior in the Arctic in the future.

Exhibit 14



5. POLICY PRIORITIES: THE EU NEEDS TO RAISE ITS CHINA GAME WITH PARTNERS

China's actions in the Western Balkans, the MENA region, the Indo-Pacific and “new geographies” of geopolitical competition, like the Arctic, are among the most pressing geopolitical challenges the EU currently faces. To contain China's actions in the Western Balkans, the EU must provide a more credible path to EU accession for countries in the region and more actively promote and facilitate access to EU investment and financing sources. The EU should also support relevant actors in the Western Balkans to adequately assess Chinese loans and investments before they are accepted.

On certain issues, the appropriate EU logic of action may also be one of “engaging and shaping” China. Where China's investments and projects align with EU norms and standards, cooperation should be considered. Europe should also use these opportunities to share best practices and promote European norms and approaches to infrastructure and investments.

The same goes for the MENA region. Overall, however, as Europe's power is lower, the EU must focus on making China a constant talking point with MENA countries, leveraging its normative and diplomatic power to persuade and pressure MENA countries to resist those Chinese activities that would be most detrimental to their relations with the EU.

Europe needs to rethink how it wants to position itself in a world of increasing geopolitical competition

Since the EU's presence in the Indo-Pacific region is limited and its relative power is lower than that of China, it is left with signaling its disagreements with Chinese policies and activities in the region in high-profile ways and resisting them where possible. Resisting China's behavior in the Indo-Pacific will require, first and foremost, cooperation with like-minded states. This should not be limited to the United States but also include other countries in the region whose values and interests in this space converge with the EU's, such as Japan, Australia, South Korea, Taiwan, India, or Vietnam. With a view to China's evolving role in the Arctic, EU member states should urgently establish close coordination and possibly even a working group that can help to coordinate EU measures aimed at containing China's role, where necessary.

Overall, it is high time for Europe to rethink how it wants to position itself in a world of increasing geopolitical competition. Although Europe's relative power vis-à-vis China is limited in many areas, it does not mean that the EU has no leverage or tools to use when confronting China's geopolitical ambitions.

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Lucrezia Poggetti: Protecting the EU's political sovereignty and unity

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Rebecca Arcesati: Competing with China in the digital age

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