

Updating the EU strategy on China: co-existence while de-risking through partnerships

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Executive summary

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THE EUROPEAN UNION-CHINA relationship has deteriorated markedly since the EU introduced a three-part strategy in 2019 based on partnership, competition and systemic rivalry. The relationship has been undermined by China's support for Russia's aggression in Ukraine and its increasingly anti-Western foreign policy that aims to alter the international rules-based system. Meanwhile, the economic relationship is changing because of China's structural deceleration and increasing self-reliance, coupled with the EU's growing critical dependence on China, especially for digitalisation and decarbonisation. Europe must accept that relations with China will not return to their pre-pandemic state.

WHILE THERE IS no need to change the overall strategy, the EU should seek co-existence with China while preserving EU values and interests. Cooperation is still needed to address global problems, including climate change, in which China plays an important role in finding solutions, but on which the EU cannot accept Chinese cooperation at any price.

IN TERMS OF CO-EXISTENCE, the EU must continue to pursue de-risking – or reducing its exposure to China – especially for its energy and digital transitions. De-risking has started but more needs to be done to understand how it can be continued while not creating conflict.

THE EU SHOULD pursue a three-part approach: increase coherence and coordination with all European stakeholders, refine the EU economic-security strategy while accepting trade-offs, and seek partnerships as the best offensive tool. The 2024-2029 European Commission should foster discussion of China and coordination of strategic issues within a larger constituency. EU countries, with Commission coordination, need to be more involved in building a comprehensive approach, including by conducting national risk assessments and by shaping and implementing de-risking measures.

ON ECONOMIC SECURITY, full implementation of current defensive instruments is needed, along with new protections, such as better coordination of export controls and a new outbound-investment screening mechanism. The trade-offs stemming from pursuing more security will need to be made explicit in order to mitigate them.

ON PARTNERSHIPS, the EU must look beyond the United States, working within the G7 and with other like-minded countries, such as Australia and South Korea, which have valuable experience of de-risking. Mutually beneficial and strategic cooperation agreements need to be brokered with relevant emerging and developing economies.

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1 How has the EU-China relationship evolved?

China's structural deceleration and increasing self-reliance have reduced the benefits that it provided to European economies during the past few decades

After a long period of engagement after China entered the World Trade Organisation (WTO) in 2001, the European Union's approach took a distinct turn in March 2019. The European Commission and the EU's foreign policy chief, the High Representative of the Union for Foreign Affairs and Security Policy, issued a new strategy that moved to a position on China with three pillars: that China was simultaneously a partner, competitor and systemic rival (European Commission/HRVP, 2019). This approach, which has been criticised frequently by Chinese officials as contradictory¹, was considered somewhat radical compared to the previous position of engagement (Garcia-Herrero, 2023a), but has been vindicated given how much EU-China ties have deteriorated since.

From a foreign policy point of view, the relationship has been undermined by China's support for Russia's full-scale attack on Ukraine and its increasingly anti-Western foreign policy, which aims to alter the international rules-based order. China's lack of transparency during the COVID-19 pandemic also undermined the relationship with the European Union (Le Corre and Brattberg, 2020).

Meanwhile, from an economic point of view, China's structural deceleration (García-Herrero, 2023b) and increasing self-reliance, coupled with the EU's growing critical dependence on China, especially for digitalisation and decarbonisation, have reduced the benefits that China provided to European economies during the past few decades. China has moved from being a foreign policy question to becoming a domestic issue for European prosperity and security because of its oversized economy, foreign policy and even security impact.

How the EU-China relationship ended up at this low point is clear. The EU last used its leverage to create a positive outcome in bilateral relations with China in 2019-2020. Years of the EU asking for better market access and reciprocity in economic relations translated into concrete momentum in the form of a political agreement on the Comprehensive Agreement on Investment (CAI), reached at the end of 2020². But this was derailed in 2021 and eventually abandoned, prompted by the European Parliament, which decided to freeze the ratification of CAI as a response to sanctions that China announced on some MEPs and European think tanks in March 2021³. Since then, relations between China and the EU have continued to deteriorate.

China's state-led system with its extensive use of industrial policy, among other tools, to support exports and globalise its companies has created major distortions in global markets. Attempts to increase market access or to spur China to become a more market-driven economy have failed. The EU's role as a major global exporter has been hollowed out, while its strategic dependence on China has only deepened since the pandemic. EU imports of green tech from China have ballooned, while China has continued to reduce its imports from the rest of the world, especially the EU (Figures 1 and 2).

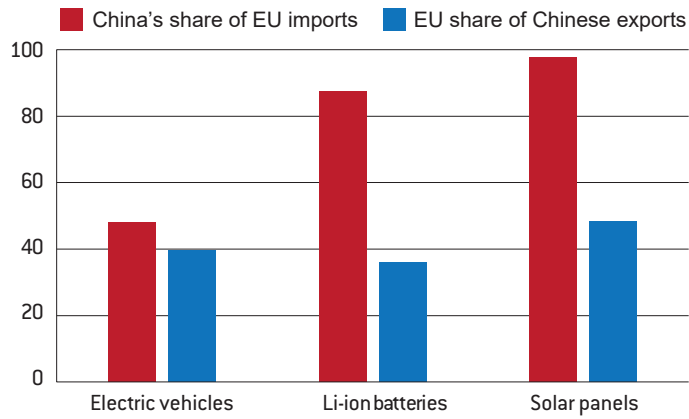
The reasons for the deteriorating relationship can be found in China's structural deceleration, which is expected to continue (Figure 3), and also in the rapidity of China's economic development and import substitution (García-Herrero, 2023b).

1 See for example Chen Qingqing, 'EU defining China as "partner, competitor and systemic rival" should be set aside: Chinese diplomat on European affairs', *Global Times*, 21 September 2023, <https://www.globaltimes.cn/page/202309/1298608.shtml>. The Global Times is the newspaper of the Chinese Communist Party.

2 See European Commission, 'EU-China agreement: Milestones and documents', undated, https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china/eu-china-agreement/milestones-and-documents_en.

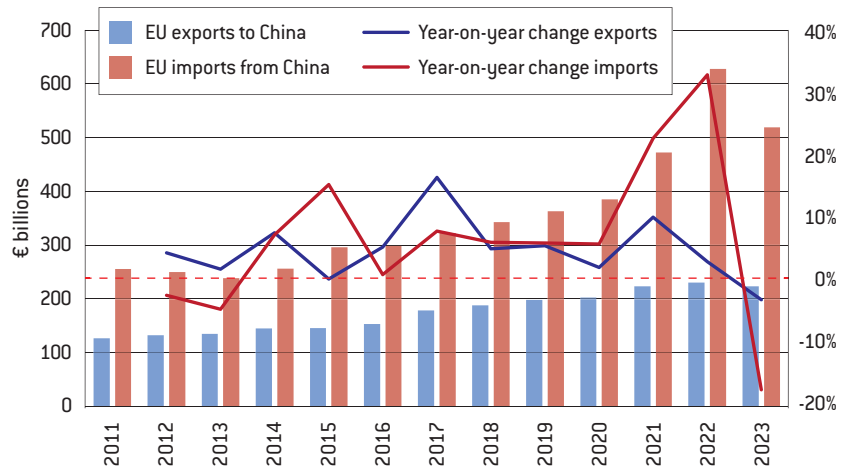
3 China's sanctions came as a response to the EU's own sanctions on some Chinese officials and entities over human-rights concerns in Xinjiang. See Council Decision (CFSP) 2021/481.

Figure 1: China/EU, direct trade exposures, selected items, 2023 (%)



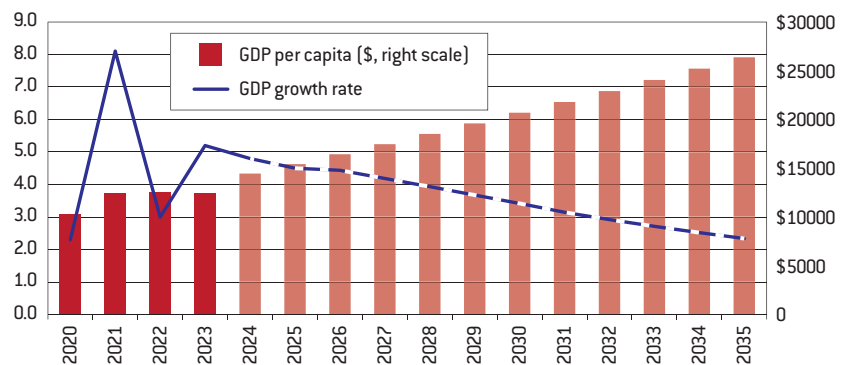
Source: Natixis, UN Comtrade.

Figure 2: EU-China trade, EU goods exports to/goods imports from China



Source: Bruegel based on Eurostat.

Figure 3: China, project GDP growth and GDP per capita



Source: Natixis, UN.

China's continuous push to move up the income ladder and its increased competitiveness, coupled with massive industrial policy, point to an ongoing clash with European interests as a global manufacturer (García-Herrero and Schindowski, 2024). It appears increasingly clear that China has no intention of changing its industrial and economic model, which is based on techno-nationalism and exports to the rest of the world.

The Chinese leadership believes that the time has come for China to regain its rightful place at the centre of world order

Politically, China's support for Russia's war effort in Ukraine is a major threat to European security, which has radically changed the perception of China among EU countries (García-Herrero, 2024) – particularly in central and eastern Europe (Silver *et al*, 2023). The so-called 16+1 cooperative framework between China and 16 central and eastern European countries, which launched in 2012, has lost steam⁴. Its last meeting was held in April 2022, just after Russia's full-scale invasion of Ukraine and before China's support for Russia was not yet evident.

The Chinese leadership also believes that the time has come to regain its rightful place at the centre of world order (Legarda, 2020) with all political, economic and military means aligned. To reach this goal, China is in a 'struggle' with the United States to win the geopolitical competition and prove its predominance (Godehardt, 2024). Moscow fully supports China's vision of the world, which calls for multipolarity as a response to a declining West. The importance of the China-Russia relationship is crucial for China's global ambition as it also drives a wedge between the Global South and the West, supporting China's objection of redefining the rules-based international order (Sabanadze *et al*, 2024). In this context, in the eyes of Beijing, distancing the EU from the US is a very important objective, as China's push to change the world order becomes much easier if the US is isolated. China is also increasingly assertive on its interests in Taiwan and the South China Sea, with potentially critical consequences for the rest of the world. All in all, China's push for a shift away from Western influence in the global order is increasingly clear.

Finally, China is fundamental to the resolution of global problems, whether climate or pandemics, given its size and their impact in China's domestic debate. On climate, China's path towards decarbonisation is proceeding but is also very dominated by industrial policy interests. As for pandemic resilience, the COVID-19 experience showed how hard cooperation can be, even when most needed.

Together, these factors frame the rapid deterioration of the EU's relationship with China. But it should also be noted that China has never been as important for the EU, both economically and politically. Together, these trends call for an urgent re-evaluation by the new European Commission for 2024-2029 of the EU-China relationship. This policy brief sets out some recommendations in this respect.

2 China policy under the 2019-2024 European Commission

The EU shift towards a robust and realist approach to China started in 2016 when the question of Chinese investment in strategic infrastructure became a public debate in several capitals. This was also when Europe integrated national security into its considerations when dealing with China, leading the EU to build a defensive toolbox, and to promote diversification away from China. The 2019 China strategy dealing with China as a partner, a competitor and a systemic rival (European Commission/HRVP, 2019) also proposed a series of EU defensive measures, including a reform of trade-defence instruments with investment screening at its core, a cyber toolbox and a recommendation for EU countries on excluding Chinese service providers from the deployment of 5G networks given national security risks.

Since 2019, the EU has sought to develop a complex and mostly efficient, sometimes incomplete, set of plans and legislative proposals for the defence and promotion of its interests. While most are country-agnostic, they all respond to the same challenge of dealing with

⁴ Piotr Maciej Kaczynski, 'How China lost central Europe', *Balkan Insight*, 15 August 2022, <https://balkaninsight.com/2022/08/15/how-china-lost-central-europe/>.

The EU is now better equipped to deal with China in a systematic way, but the question remains whether the existing tools will be enough

China and, in some cases, Russia. While the EU is now better equipped to deal with China in a systematic way, the question remains whether the existing tools will be enough to ensure the EU's prosperity and security.

More specifically, the defensive toolbox⁵ was developed as a response to Chinese industrial policy-led competition in the EU single market and to Chinese aggression against some EU countries, such as Lithuania⁶. On the former, the EU Foreign Subsidy Regulation (Regulation (EU) 2022/2560), enacted in 2023, enables the European Commission to address distortions caused by foreign subsidies to ensure a level playing field for all companies operating in the single market. On the latter, the EU Anti-Coercion Instrument (Regulation (EU) 2023/2675), also finalised in 2023, aims to deter coercive actions by foreign powers that threaten the integrity of the EU's single market or its political stability by potential deployment of import tariffs and other trade barriers.

Other actions push reciprocity to the greatest extent possible. For example, the International Procurement Instrument (Regulation (EU) 2022/1031), introduced in 2022, allows the Commission to impose measures to restrict the access of companies from non-EU countries to EU public tenders, based on reciprocity. Finally, the EU's Corporate Sustainability Due Diligence Directive (CSDDD, Directive (EU) 2024/1760) aims to protect EU citizens from products marked by human-rights violations in their supply chains. It requires companies to carry out risk-based human rights and environmental due diligence to prevent and manage "adverse impacts". Companies can be fined if found not to have conducted such due diligence or taken action on any potential exposure to human-rights violations.

The COVID-19 pandemic and Russia's invasion of Ukraine made it very clear that excessive dependence on imports of critical goods could become a major security problem for the EU. The European Commission thus conducted a review of the EU's critical dependencies on China, with particular attention paid to critical raw materials for Europe's digitalisation and decarbonisation. The policy measures implemented as a response to the finding that there was extreme dependence on China for a wide range of critical products have become the basis for the EU's de-risking strategy. This has been accompanied by a number of legislative measures to push diversification, including the Critical Raw Material Act (CRMA, Regulation (EU) 2024/1252) and the Net Zero Industry Act (NZIA, Regulation (EU) 2024/1735). The EU's de-risking efforts were crystallised in the European Economic Security Strategy (European Commission/HRVP, 2023) with the key objectives of reducing risks to Europe's supply chains and critical infrastructure, while maintaining energy and technology security. China is the main concern behind these risk factors even if the official strategy is country-agnostic.

The growing legislative toolkit to protect the single market has started to be used with an increasing number of cases under investigation, most of which feature China⁷. The highest profile investigation is the anti-subsidy probe into electric vehicles (EVs), which has resulted in the imposition of countervailing duties on EVs produced in China⁸. But EU countries were split on this, with Germany, among others, opposing the Commission's proposal for duties. This, along with the many more investigations underway, and how little de-risking has been achieved so far, suggests the Commission might need to re-evaluate its approach.

On the offensive side, the EU's first priority in relation to China has been diversification. A series of trade and digital partnerships have been signed with partners in the region (Japan,

5 It should be noted that several of these instruments were conceived under the Commission of Jean-Claude Juncker (2014-19).

6 In August 2021, China responded to the opening of a Taiwan representation office in Vilnius by exercising economic coercion against Lithuania, blocking Lithuanian products at the Chinese borders to force Vilnius to change its decision. Discussions between the EU and China are ongoing at the WTO to address this issue (MERICS, 2024).

7 According to European Commission (2024), 75 percent of the cases under investigation relate to China.

8 See for example Ignacio Garcia Bercero, 'EU duties on Chinese electric cars are a rule-respecting response to subsidies', *First Glance*, 10 October 2024, Bruegel, <https://www.bruegel.org/first-glance/eu-duties-chinese-electric-cars-are-rule-respecting-response-subsidies>.

India, South Korea, Thailand). Accompanied by the European Indo-Pacific strategy, the EU has tried to develop a vision for the region that would move away from a China-centric and trade-based approach. More broadly, the EU Global Gateway (European Commission/HRVP, 2021), an international investment strategy with a €300 billion budget by 2027, aims to boost smart, clean and secure links in the digital, energy and transport sectors, and to strengthen health, education and research systems across the world. This can be considered the EU's response to China's Belt and Road Initiative (BRI).

Beyond the EU's own initiatives, the G7 has become increasingly vocal on China and has initiated several strategies to tackle the negative effects of China's growing assertiveness in the global arena and its non-market practices. The Partnership for Global Infrastructure and Investment⁹, for example, aims to finance sustainable and high-standard infrastructure projects in developing countries. Together with EU Global Gateway, this forms an offer to the Global South as an alternative to the BRI.

In the same vein, G7 countries have agreed to enhance cooperation on securing the supply of critical minerals and materials, which are essential for various industries and technologies. This complements the EU CSDDD and US legislation on security and resilience of supply chains (The White House, 2022). Finally, the G7 has also become a platform to coordinate sanctions against Russia and to impose export controls, particularly on dual-use technologies. It has also helped put more pressure on China for human right violations, spotlighting issues in Hong Kong, Xinjiang and Tibet.

3 State of play as a new European Commission takes over

Compared to 2019-2024, the 2024-2029 European Commission is taking office with a radically different starting point on EU-China relations and the trajectory of the Chinese economy. The need to preserve the level playing field is becoming increasingly intertwined with national security when dealing with China, and the balance between opportunities and risks has shifted dramatically.

Whereas the Chinese economy was growing at over 10 percent per year and engaging in large imports of machinery, chemicals, autos and luxury goods – representing a massive opportunity to EU firms – its growth is now waning. China can produce most of what it needs, which limits market access for European firms in China. Furthermore, the return on investment in China is much lower now given ferocious competition and the lack of domestic demand, which are leading to price wars and overcapacity.

Meagre growth in most European economies since the energy price shock caused by Russia's invasion of Ukraine led many European companies to find respite in the Chinese market – the second largest in the world. But such respite is waning as China's growth reduces and national security trumps the economy (European Chamber, 2024).

Meanwhile, Europe has increased imports from China massively since the pandemic, deepening its dependence. China is a massive competitor in third markets and increasingly in the single market. Its threat to European security because of its leader's support for Russia has become a major issue of contention, with targeted sanctions being imposed on Chinese companies that export dual-use technology to Russia¹⁰. Overall, China's increasingly pervasive

9 See The White House, 'FACT SHEET: Partnership for Global Infrastructure and Investment at the G7 Summit', 13 June 2024, <https://www.whitehouse.gov/briefing-room/statements-releases/2024/06/13/fact-sheet-partnership-for-global-infrastructure-and-investment-at-the-g7-summit-2/>.

10 *France 24*, 'EU hits 19 Chinese firms with sanctions over links to Russian war effort', 25 June 2024, <https://www.france24.com/en/europe/20240625-eu-hits-19-chinese-firms-with-sanctions-over-links-to-russian-war-effort>.

presence in Europe is making it a domestic issue, with Europeans feeling that their prosperity and also their security are at stake.

In terms of the global backdrop to the EU-China relationship, the strategic competition between China and the US deepened during the Biden administration. The 2024 US presidential election campaign made it very clear that China has become a domestic issue for the US electorate, meaning that technological and military containment can be expected to continue. Beijing is bound to become more assertive, leaning further towards the Global South to design an attractive alternative to the Western-led world order.

If the EU finds itself less protected by a strong transatlantic partnership in navigating growing competition with China, it will need to develop further its strategic autonomy¹¹, as it started doing during Trump's 2016-2020 administration.

Against such a backdrop, the EU needs to be aware of the increasing risks associated with its relationship with China, and its waning leverage as the European economy shrinks compared to China's. There is still opportunity because the EU remains China's largest export market, given how fast US de-risking has advanced and the still moderate size of emerging economies as markets for Chinese exports, especially for newer industries, such as green tech for which the EU buys 55 percent of Chinese exports.

4 A renewed comprehensive European approach to China

Against the backdrop of the deteriorating EU-China relationship, the first step for the 2024-2029 European Commission should be to redefine its objectives on China. Generally, the EU should aim to manage coexistence with China, while staying true to its interests, principles and values.

When unpacking the idea of managing co-existence, several clarifications are warranted. Europe must accept that China's size and political power are bound to be long-lasting, even if the economy continues to decelerate structurally. This also means that Chinese and EU economies will continue to be entangled and that any attempt to decouple from China will be difficult¹². Entanglement will persist while sometimes unfair competition in third markets and differences in economic models and values widen. In other words, co-existence will be harder than in the past but is still warranted because of the major role that China plays, from climate change action to global health and pandemic resilience.

Meanwhile, though the need for cooperation on global challenges is undeniable, it is not without limits. In other words, the EU needs to continue to safeguard and promote its values and interests when cooperating with China, meaning cooperation cannot come at any price.

Given the objective of managing co-existence, the question is what the EU should do to achieve it. As part of its response, the EU must continue to upgrade by responding to China's systemic competition in economic terms but also by upholding global values. For the former, the EU must increase its competitiveness, while protecting itself from unfair competition. On the latter, the EU needs to maintain a functioning global and multilateral liberal order. China's size and influence is such that such actions require full alignment within the EU institutions and among member states on key EU-China issues. The building of strong partnerships outside of the EU is also needed, and these must go beyond the US.

Regarding EU-level unity on core issues related to China, the economic benefits of trade

¹¹ For a review of the concept of EU strategic autonomy, see Damen (2022).

¹² There are different views on the feasibility of decoupling and its costs. Pisani-Ferry *et al* (2024) argued that the cost could be more moderate than previously thought.

Europe must accept that China's size and political power are bound to be long-lasting, even if the economy continues to decelerate

with and investment in China have made some Europeans – whether governments or companies – blind to its rising (economic) security challenge. Ensuring EU countries agree on core positions on China is needed to protect European interests, especially the single market. Against such a backdrop, security – physical and economic – will become central to the 2024-2029 Commission’s strategy.

Beyond the stated objective and the main steps forward, the leadership of EU institutions for the next five years should have three main priorities for the EU relationship with China:

1. Coherence and coordination in implementing the China strategy,
2. A further focus on economic security,
3. More reliance on partnerships.

4.1 Priority 1: Developing increased coherence and coordination with European stakeholders to implement the European strategy on China

The current European strategy on China, based on the promotion and defence of European interests and security, under the motto of ‘protect, promote and partner’, is comprehensive enough and in line with an objective of EU-China co-existence, while protecting EU values and interests.

While no reset is needed on the strategy’s design, much more needs to be done for it to be accepted by different stakeholders, and on its implementation. The EU needs in general coherence and coordination in its policies, but this is even more the case when dealing with the Chinese government, which presents a united front to 27 diverging EU national interests. Coordination among EU countries, the European Commission and the European External Action Services (EEAS) must be reinforced, as it should also be among diplomatic services in Beijing and across the world. Such coordination cannot only be procedural or tactical, it must also be strategic.

The US model relies on a number coordination tools, including the so-called ‘China House.’ This gathers different parts of the government and experts to brainstorm on China issues, shaping US strategic decisions on China. Following the US example, the EU could also create a ‘China House,’ which should involve the Commission, the EEAS, the Council of the EU, member states and other key stakeholders. One workstream for this European China House could be dedicated to outreach to national and European Parliaments and to the business community to provide strategic guidance and analysis.

The European Council and Council of the EU also need to give greater priority to discussions about China. These are too often left to EU countries’ representatives to the EU or to officials in Beijing, and are mostly attached to a schedule. To prepare China-related issues comprehensively, information on China needs to flow between the 27 EU countries so that China-related discussions at the Council of the EU are better coordinated in advance.

Institutional mechanisms in Brussels are useful for the coordination of policymakers, but other stakeholders, in particular the private sector, need to be involved since their views on China are even more diverse than those of the 27 member states. Limiting the risks that companies may face given the deteriorating EU-China relationship is important.

The first step should be to seek companies’ views on the implementation of the EU strategy on China, especially de-risking aspects. This means offering alternative to China to EU companies, to facilitate de-risking. New options should cover both new markets for EU exports and foreign direct investment, and also for sourcing, given the very high dependence on China for European imports. In other words, the EU needs to help companies to avoid investing only in China and to diversify business into other countries.

To this end, new – and more rapidly implemented – trade and investment deals will surely be needed. As far as coordination is concerned, a European China House could also seek views and comments from European companies exposed to China. A more inclusive

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approach to the implementation of the EU's China strategy should help foster a common vision on how to preserve European interests in a world of strategic competition.

4.2 Priority 2: Refining the EU economic security strategy while accepting trade-offs

Given that China is becoming more a competitor and systemic rival to the EU than a partner, more needs to come and in terms of developing and implementing the EU economic security strategy.

To start, the vulnerabilities in each EU country should be evaluated, beyond the useful EU-level exercise already conducted by the European Commission (Arjona *et al*, 2023). A national-level survey could help to identify resilience priorities.

Once vulnerabilities at national level have been mapped in detail, the EU and member states need to agree on which objectives are essential, for which unanimity is needed and for which it is not. An important guiding principle for the EU economic security strategy is to acknowledge that, in a world of great power competition, the first best – all participants playing by the rules – is no longer feasible, and so embracing economic security is a second best, not a third or last option (Duchâtel and Godement, 2023). This means that the objectives the EU intends to achieve with the strategy will come at a cost: trade-offs will be needed.

While the European economic security strategy needs to be designed broadly to account for all types of risks from different sources, it is still important to establish a China-specific framework. The four most relevant considerations in this are:

1. European security is non-negotiable, which means that Beijing needs to cease its support for Russia's war efforts.
2. An effective multilateral system is also essential for Europe to uphold its principles and values, so the EU will use its leverage to ensure that Beijing does not act against it.
3. European prosperity is important, which means that the EU should continue to pursue better market access and a level playing field for European companies operating in China. Such access, though, cannot come at the cost of the EU losing control of its core technology and strategic assets.
4. The EU's safe digitalisation and green transition are important objectives that need to be preserved, but with full account taken of the risk derived from excessive dependence on Beijing, including potential weaponisation of critical technologies and supplies.

These considerations cannot be managed without costs so trade-offs will need to be made explicit. The first and second considerations do not offer room for concessions. First, within the security realm, the EU needs to increase the cost to China of its potential military support for Russia. Current sanctions on a few Chinese companies exporting dual-use technologies are still much more limited than those imposed by the US. In addition, European policymakers are grappling with a new reality in which conflicts are increasingly interrelated, meaning security and stability in the South China Sea and the Taiwan Strait are likely to insert themselves more into the European agenda. EU countries have a duty to prepare for all scenarios and take seriously the question of burden sharing and burden shifting in their commitment to the future of European security.

On the second consideration and objective of maintenance of the multilateral system, values and principles cannot be subject to compromise either. The fundamental divisions between China and the EU on the definition of human rights and democracy will continue. The challenge for Europe will be to ensure that the global liberal order does not become 'with Chinese characteristics,' which could happen if the United Nations's key principles are reviewed. Pursuing these two objectives will probably come at the cost of even deeper disagreements with China, which European companies will need to accept. The alternative scenario would surely more costly for all, including European companies.

To preserve the EU's technological edge, the introduction of outbound investment screening is clearly warranted

In the realm of economic prosperity, Europe will need to protect its economic interests while ensuring long-term competitiveness. Major trade-offs will emerge from the de-risking strategy, requiring compromises. First, Europe's critical dependence on Chinese imports needs to be reduced, even if it comes at the cost of higher inflation. Building strategic stocks of critical raw materials and creating incentives for companies to diversify their sourcing are potentially useful measures. Second, the excessive dependence of European companies on the Chinese market (as investors or exporters) needs to be tackled too, especially if it comes with forced technological transfer. Policies to support business diversification strategies need to come with specific rewards (Draghi, 2024).

To preserve the EU's technological edge, the introduction of outbound investment screening is clearly warranted, along with strengthening of existing inbound investment screening. In fact, China can gain access to technology easily within EU single market through mergers and acquisitions and not only through the operations of European companies in China. To make investment screening more effective, the EU and member states have established a list of critical technologies and developed a risk assessment on this basis. The next steps will need to focus on implementation.

Another important measure to reduce the leakage of technology, especially if for dual use, would be for the EU to improve export-control mechanisms and their EU-level coordination. More generally, the EU Intelligence and Situation Centre (EU INTCEN, part of the EEAS), a 'civilian intelligence function' should get more involved in the regular assessment of critical dependencies. This will also require a greater effort to address China's talent-acquisition strategy.

While the door for negotiation should remain open, any potential negotiation between the EU and China should not challenge the need for de-risking, though it might address its speed. In exchange for slower de-risking from the EU side, China could offer better market access and level playing field for European companies. However, forced transfer of technology and the instruments to protect Europe from losing core technologies should never be part of the negotiation.

Regarding the implementation of a de-risking strategy, the Commission should take the lead on the design, though coordination between the Commission and EEAS will be crucial, and probably justifies the designation of an EU coordinator on economic security. Similarly, to increase coherence in member states on economic security, a Council working group will need to be created. This should not be surprising, as China's impact on European prosperity and security is simply too large to tackle with existing structures of coordination.

Guidelines and coordination are obviously insufficient for a successful de-risking strategy. Member states must continue to be involved after having finalised their national risk assessments. They need to work with companies, research centres and universities, all key actors for de-risking, to harmonise and update export-control regulations and processes, and also rules on security of research cooperation. In the same vein, the role of EU countries in inbound investment screening is crucial; similarly for new outbound investment screening once implemented. Against such a backdrop, capacity building in China-related intelligence, possibly bringing in China experts with technology backgrounds, will be needed both for administrations and companies (Gehrke and Medunic, 2024).

Finally, it seems clear that the consequences for companies and EU countries will be asymmetric. This justifies very close coordination at EU level. The response to the COVID-19 pandemic is a good benchmark for what is needed. Companies and government also need to work together on possible retaliation from China. First, understanding the probability and impact of Chinese retaliation is important, as it is often overstated. Second, planning for contingency is needed, ranging from provision of European solidarity funds to preparing to use the Anti-Coercion Instrument.

The EU needs to continue to develop a comprehensive and strategic offer to the Global South

4.3 Priority 3: Using partnerships as the best offensive tool

Europe needs partners for many reasons. First, partnerships can help mitigate the costs of the necessary de-risking from China. Second, others may have valuable experiences to share on how to co-exist with China. The US remains the EU's most important ally, but uncertainties are growing as to whether the US will continue to engage as closely as before with the EU. The importance of the transatlantic relationship is being continuously tested not only because of isolationist trends in the US – increasingly obvious during the US presidential campaign – but also because of the rising importance of the Indo-Pacific economically and security-wise.

The EU needs to turn this challenge into an opportunity by strengthening ties with others, especially with middle powers, which might either be wary of the increasing competition/rivalry with China, or which simply look to reduce their dependence on China. Three goals should be prioritised.

First, the engagement at the G7 on China issues, which started in earnest under the 2019-2024 Commission, is expected to continue. Beyond initiatives already underway, more can certainly be achieved on climate and energy cooperation, as well as on the digital economy, governance of artificial intelligence (AI) and cybersecurity. Finally, the G7 might want to engage in closer scientific cooperation on key emerging technologies, including AI, quantum computing and semiconductors. This is even more important given how fast China is moving ahead and how these emerging technologies are essential to China's military upgrade.

Second, closer ties with other like-minded countries beyond the US and G7 members are needed, in particular Australia and South Korea. Both countries have experienced retaliation from China and have introduced specific policies to reduce their exposures to China, many of which have been effective¹³. The EU should aim at knowledge sharing and, potentially, coordination of responses to possible threats from China.

Third, the EU needs to continue to develop a comprehensive and strategic offer to the Global South. This group is not as monolithic as it might appear in the Chinese narrative. Emerging and developing countries are looking for alternatives to the US and China in order to counterweigh the two. The EU can offer that middle ground by supporting emerging and developing economies in their infrastructure, green and digital goals through the Global Gateway.

Moving to the nature of the partnerships, the EU has long considered that trade and investment agreements – with some additional clauses on labour rights and commitments to decarbonisation – are paramount as part of a strategic partnership. In the new great power competition, national and economic security become crucial for trade and investment relations. This puts the EU at a disadvantage compared to the United States, which can offer a security shield.

An additional problem is that EU trade and investment deals have become harder to ratify because of rising populism in the EU. Reality and urgency should lead the Commission to consider sectoral and strategic agreements, prioritising countries with large markets and those with the critical raw materials needed to reduce EU dependence on China for the energy transition.

India is a very good example of a country with the necessary market size to facilitate de-risking from China through diversification. Negotiations between the EU and India have often been difficult but it would now be advantageous to explore faster solutions for what is most important for European companies: access to the Indian market through foreign direct investment. Such a deal would offer European companies incentives when pursuing de-risking from China.

As for access to critical raw materials, the EU should offer deals that offer more to recipients than China currently offers. The EU needs to go beyond securing sourcing (ie controlling

¹³ In the case of South Korea, major businesses exposed to China decided to reduce their exposure and the government also offer rewards for diversification (García-Herrero, 2024). Australia also diversified its exports after being retaliated against, but it has gone back recently to a similar level of dependence on Chinese exports.

extraction) to facilitating the refining and manufacturing of green tech by targeted countries. For these deals to be even more appealing for recipients, they could be linked to funding for decarbonisation and/or technological transfer, to facilitate the refining/manufacturing (for more details, see García-Herrero *et al*, 2023). Finally, on digital partnerships, the EU has moved forward with South Korea and Japan. Taiwan should probably be the next economy to consider given its strides in digital legislation since 2023, in terms of both data protection and addressing misinformation.

On a multilateral level, reform of the World Trade Organisation remains a crucial goal that the Commission has been pursuing for years. While continuing with this endeavour, the Commission should also implement a hedging strategy by working with mini-lateral groupings. Finally, any second best, in terms of smaller groupings of countries accepting new international trade legislation, will need to include at least a good part of the emerging and developing world to be meaningful.

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