China-EU roller-coaster relations:
Where do we stand and what to do?

Alicia García Herrero
Senior Research Fellow at Bruegel

1. Brief history of Europe's shifting relations with China

After a long period of engagement since China entered the World Trade Organization (WTO) in 2001, its ties with the European Union (EU) took a distinct turn in March 2019 when the European Union, in its "EU-China Strategic Outlook", moved to a three-pronged position on China, namely that of partner, competitor and systemic rival.[1] This was seen as quite a drastic move from a past dominated by engagement and interdependence. A good example of this endeavour is the EU-China 2020 Strategic Agenda for Cooperation, initiated in 2013, and the start of negotiations for a bilateral investment agreement in the same year, which was concluded in December 2020 under the new name of the Comprehensive Agreement on Investment (CAI) but never ratified for reasons which will be explored later.

The question to ask ourselves is how to explain the EU's sudden move from engagement to a much more complex relation with China.

2. Reasons behind the shift

Some analysts of EU-China relations, especially those in China, argue that the EU is simply following the US when deciding on its bilateral relations with China. This, in my view, misses two important points: firstly, the rapidly deteriorating economic relations between the EU and China, at least from the EU's perspective; and secondly, key political events which have marked relations during the last few years. The most obvious one is Russia's invasion of Ukraine, but also reciprocal sanctions, as will be explained.

2.1 Economic factors behind the EU's shift

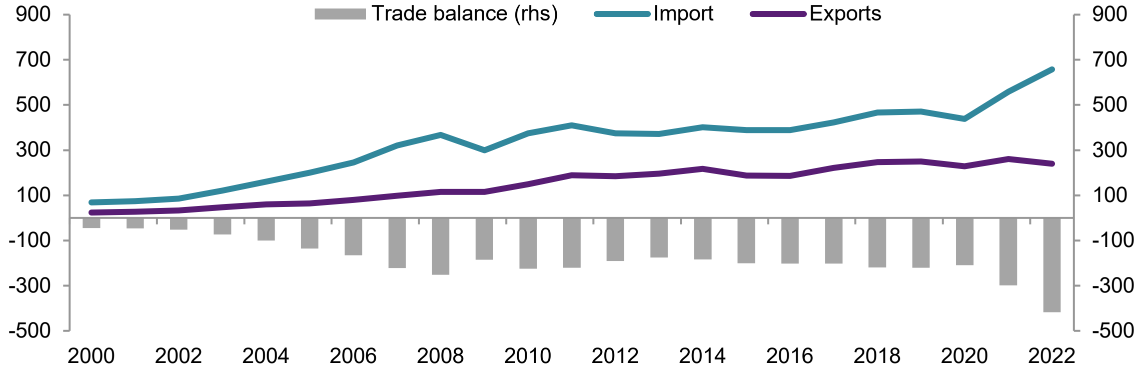
EU member states have benefitted very differently from China's economic rise, with Germany having long been the largest beneficiary. Such benefits, though, have started to wane, not only for the EU as a whole, but also for individual member states.

[1] The EU-China strategic outlook (The EU Commission and the High-level Representative Office, 2019), https://commission.europa.eu/system/files/2019-03/communication-eu-china-a-strategic-outlook.pdf

2.1.1 Increasingly unfavourable trade balance

The EU has long enjoyed rather balanced trade with China but, since the start of the pandemic, the trade deficit has ballooned to $418bn in 2022 from a rather balanced position in the early 2000s (Graph 1). The situation is unlikely to revert given the EU's heavy reliance on Chinese imports for its green energy transition, which has only accelerated since Russia's invasion of Ukraine in February 2022.

Graph 1
EU Trade Balance with China (USDbn)

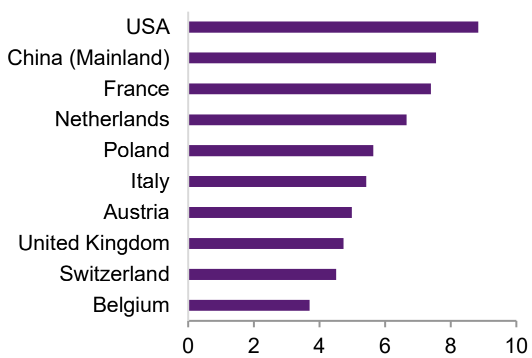


Source: Natixis, Comtrade

Germany has also gone through a deterioration of its bilateral trade relations, with a large deficit in 2022. Furthermore, China has become the largest trading partner for Germany on the import side while the US remains Germany's largest export market (Graph 2).

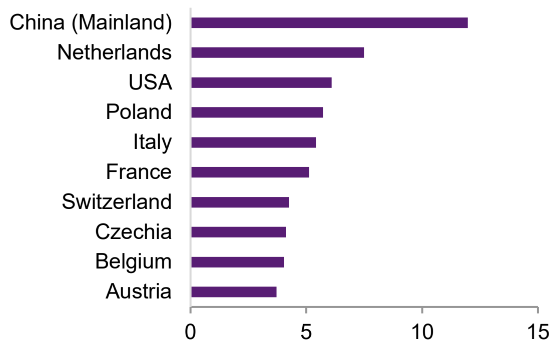
Graph 2

Top 10 destinations for German exports (% total)



Source: Natixis, UN Comtrade

Top 10 sources for German imports (% total)

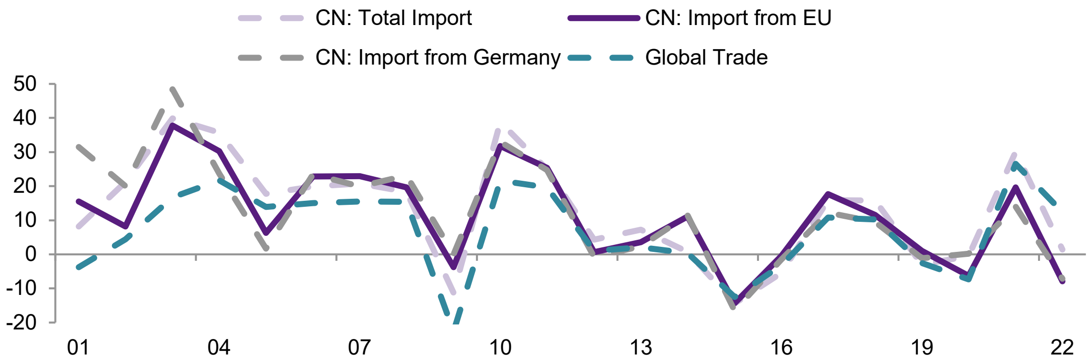


Source: Natixis, UN Comtrade

2.1.2 China's shrinking market for European exporters

The EU as a whole, as the largest export engine in the world, has always held high expectations for China's market. China became increasingly appealing with the surge of imports following the massive stimulus program introduced during the global financial crisis. However, the situation has changed quite drastically as imports have remained stagnant since the start of the pandemic and actually shrunk in 2023, notwithstanding China's reopening. In fact, China's imports are now growing at a slower rate than global trade, which is difficult to explain for an economy which is growing much faster than last year. As if this were not enough, Chinese imports from the EU, including Germany, have done worse than the global average. (Graph 3)

Graph 3
China Import and Global Trade Growth (% YoY)

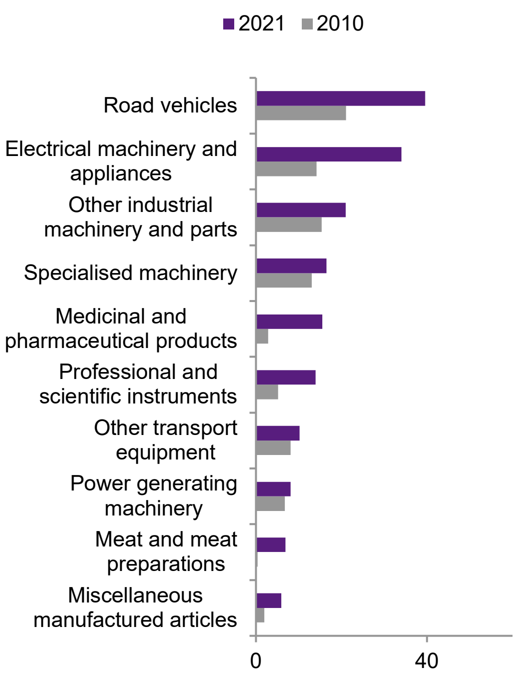


Source: China General Administration of Customs, WTO

The main reason for the relatively poor performance of EU exports to China is related to China's rapid transformation in terms of industrial capacity, which has allowed the country to move up the ladder and compete with Germany in a larger number of sectors (Graph 4). Such a shift may be partially due to market forces and innovation but also industrial policy, such as Made in China 2025, promoting self-sufficiency, with targets for localization of production.

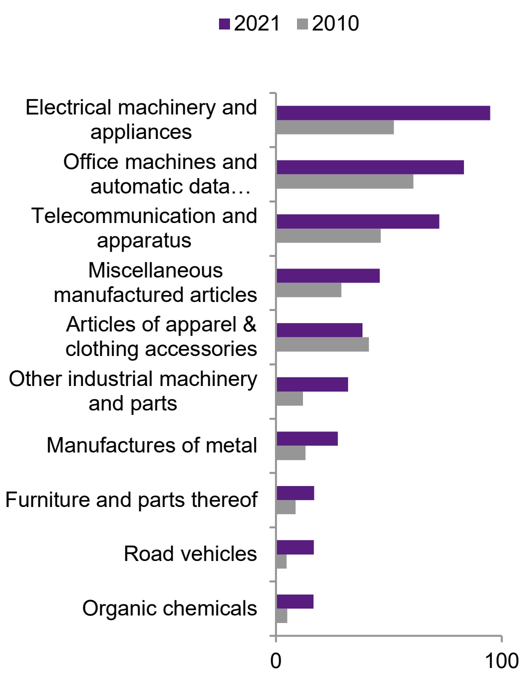
Graph 4

EU Exports to China by Sector (USD mn)



Source: UNCTAD

EU Imports from China by Sector (USD mn)



Source: UNCTAD

2.1.3 EU strategic dependencies for sourcing

The EU's high dependence on China for critically important products became apparent during the pandemic, especially for pharmaceuticals and protective equipment. In fact, recent work conducted by the EU Commission points to a large number of critical dependencies for the EU.[1,2] More specifically, looking into EU imports for critical infrastructure including energy, telecommunications, healthcare, agriculture, and IT, we find that some of the key imports for such sectors are dominated by China.

Below is a table with a cutoff point at 40% of total EU imports for key components or products that go into critical infrastructure. It is hard to judge to what extent these dependencies are risky and how important each product category is, but it offers a sense of where the EU stands with general critical dependencies beyond the work carried out by the Commission.

Table 1. EU's dependency on imports from China by product

Product category	Dependency on China for imports (as % of total)	Import value 2022 (EUR)
Monitors and projectors	74%	€8.8bn
Automatic processing machines and units thereof	73%	€48bn
Floating docks, submersible platforms, light vessels (port equipment)	65%	€360mn

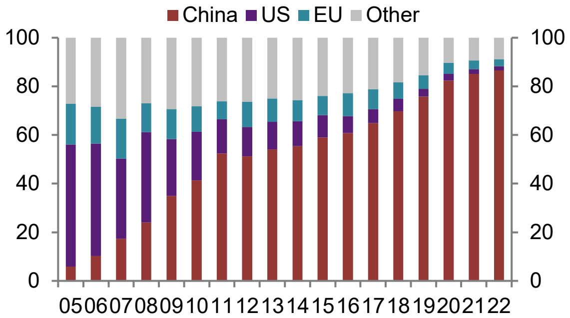
Electrical apparatus for **line** telephony (mainly used in offices)	63%	€52.5bn
Electric transformers, static converters, and inductors	63%	€14bn
Generators	58%	€1.2bn
Forklifts and work trucks	54%	€930mn
Electrical machines and apparatus	52%	€3bn
Sirens and alarms	51%	€1.9bn
AC generators (used in hydro, wind, NG power plants, etc.)	49%	€180mn
Harvesting, threshing, and other agricultural machinery	44%	€1.3bn
CCTV equipment	44%	€2.4bn
Medical, surgical, and dental furniture	41%	€207mn
Air or vacuum pumps, gas compressors and fans (industrial)	40%	€3.6bn
Agricultural machinery for soil preparation	40%	€329mn

Source: Eurostat, Bruegel

The EU's economic dependence on China has become even more apparent with the advent of the green energy transition, given its increasingly dominant position in the manufacture of green energy products such as solar photovoltaic (PV) panels, representing 87% of global production and supplying 89% of total EU imports in 2021, in a market that used to be dominated by the US and Europe before 2008. (Graphs 5 and 6).

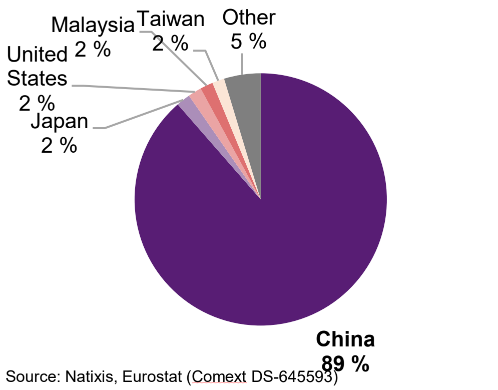
Moving to batteries for electric vehicles (EVs), China controls more than 60% of global manufacturing of lithium-ion batteries (Graph 7), but the concentration of EU imports of such batteries coming from China is even higher at 82% of total imports (Graph 8). This is striking given the EU's long-term dominance in the auto sector. In the same vein, the EU long dominated the production of wind turbines, but China has gained market share in this sector too and is the global leader since the start of the pandemic (Graph 9). Furthermore, EU imports of wind turbines from China reached 64% of total imports in 2021 (Graph 10).

Graph 5
Share in Solar Panels All Components Manufacturing (%)



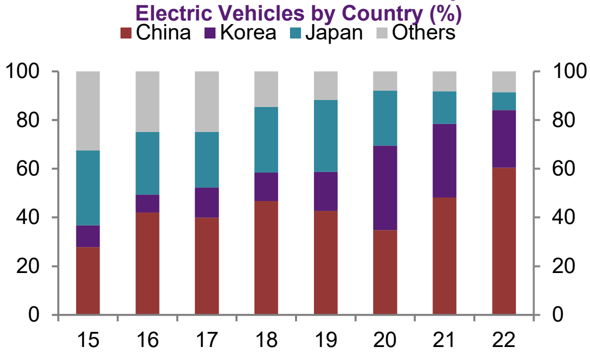
Source: Natixis, BNEF

Graph 6
Extra-EU imports of solar panels, 2021 (%)



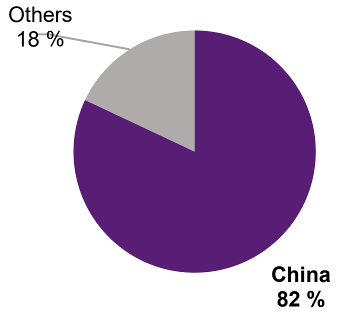
Source: Natixis, Eurostat (Comext DS-645593)

Graph 7
Market Share of Lithium-ion Battery for Electric Vehicles by Country (%)



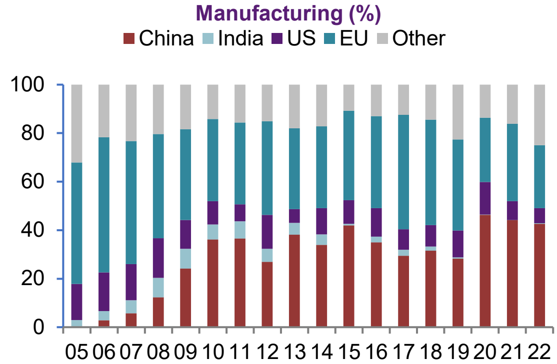
N.B. Included top 10 players for each year.
Source: Natixis, SNE Research

Graph 8
Extra-EU imports of lithium ion batteries, 2021 (%)



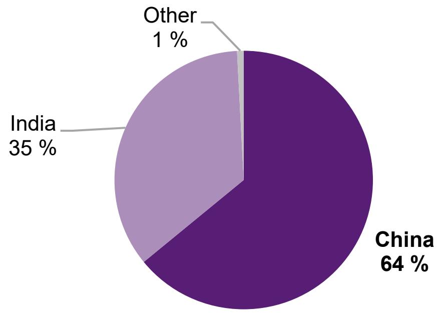
Source: Eurostat

Graph 9
Share in Global Wind Turbine Manufacturing (%)



Source: Natixis, BNEF

Graph 10
Extra-EU imports of wind turbines, 2021 (%)

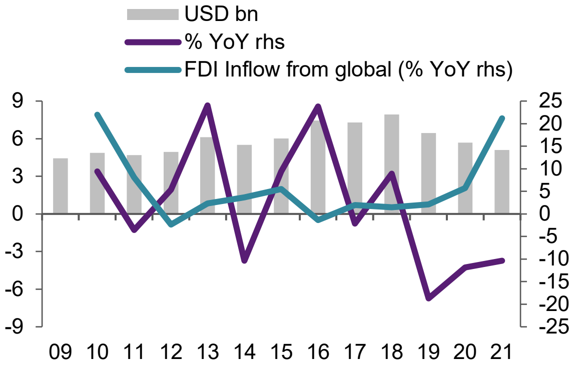


Source: Natixis, Eurostat

2.1.4 EU FDI into China is decelerating

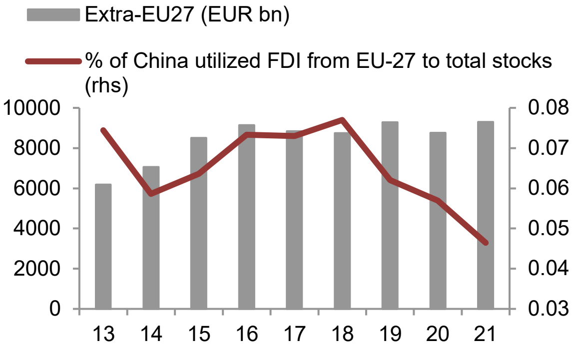
European foreign direct investment (FDI) into China has suffered from three years of zero-Covid policies as well as a much tighter regulatory environment, especially as far as data localization and national security are concerned. In fact, since 2019, global FDI into China has been growing faster than that of the EU (Graph 11), which can be interpreted as the EU being increasingly cautious about its FDI into the Mainland. The share of EU outward FDI into the Mainland has been decreasing over time from close to 8% of the total stock in 2018 to 4.5% in 2021.

Global 11
China: FDI Inflow from EU-27



Source: China Ministry of Commerce

Graph 12
EU: Outward Direct Investment Stocks

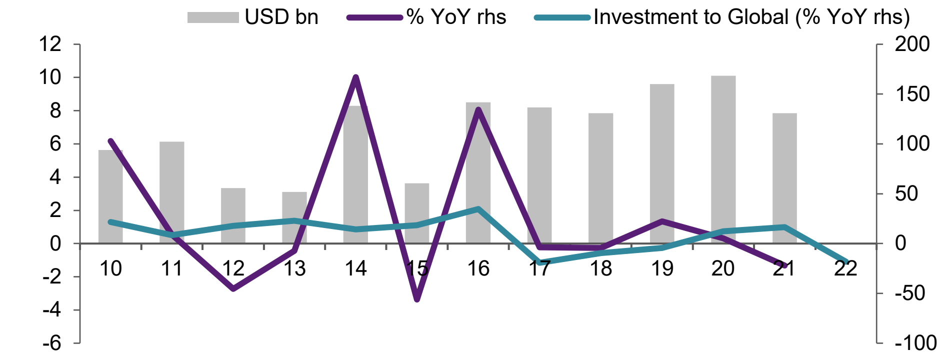


Source: Eurostat, China Ministry of Commerce

2.1.5 *China's outbound FDI is decreasing globally*

China's outbound FDI has been stagnant, or even decreasing, since 2017. On the contrary, China's outbound FDI into the EU remained strong until 2020 but plummeted in 2021 (Graph 13), with the trend continuing in 2022 according to a report by Rhodium.[2]

Graph 13
China:Outward Investment into EU-27

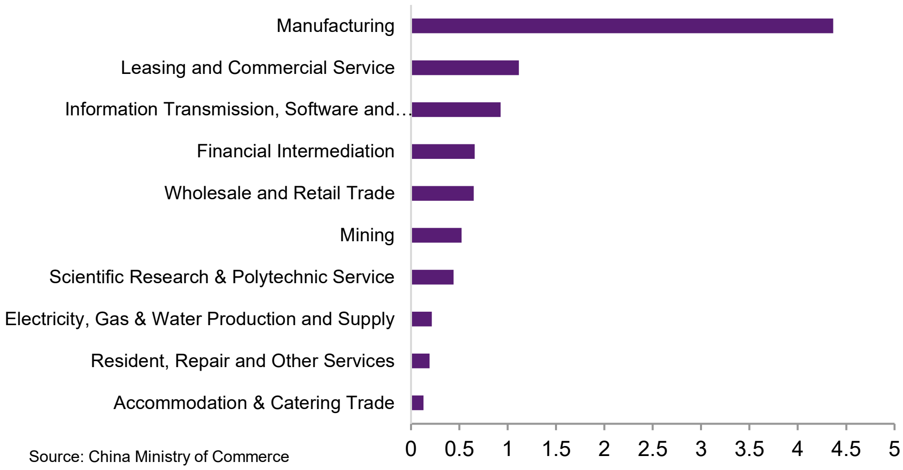


Source: China Ministry of Commerce

Another important point to note is that China's FDI into the EU has become much more targeted towards the manufacturing sector, a longstanding key comparative advantage for the EU (Graph 14).

[2] https://rhg.com/research/chinese-fdi-in-europe-2022-update/

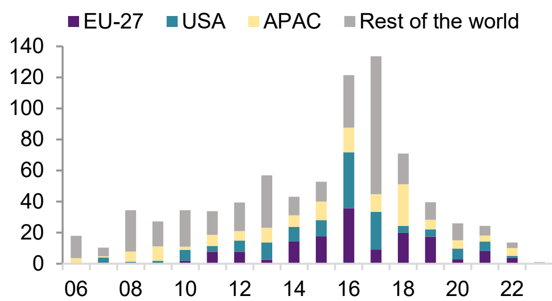
Graph 14
China Outbound Investment into EU:
Top 10 Sectors (2017-2021 average, USDbn)



Source: China Ministry of Commerce

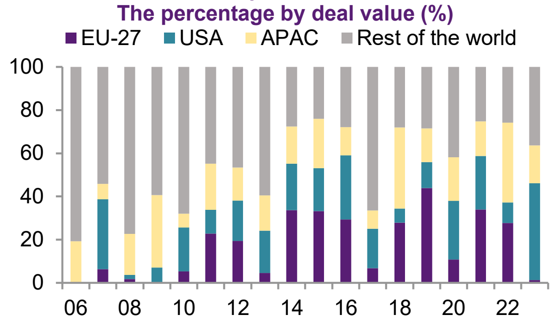
Moving to mergers and acquisitions (M&A), the EU has been an important target for Chinese overseas M&A in the last decade, but this has been waning both in absolute terms and as a percentage of the total, especially in 2023. (Graphs 15 and 16). The sector attracting the most M&A from China in the EU has been the automotive sector, which is an interesting finding given the recent loss of competitiveness of the EU's automotive sector relative to China, especially when it comes to electric vehicles. (Graph 17).

Graph 15
China: Destination of the overseas completed M&A (USD bn)



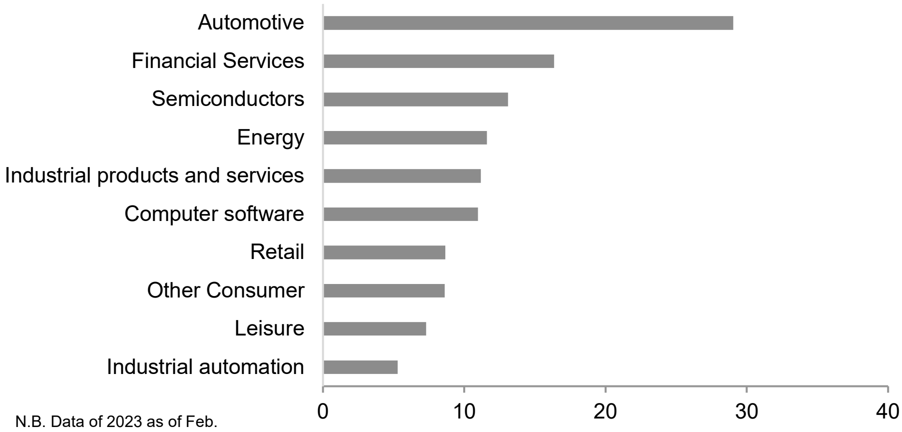
N.B. Data of 2023 as of Feb.
Source: Mergermarket

Graph 16
China: Destination of the overseas completed M&A
The percentage by deal value (%)



N.B. Data of 2023 as of Feb.
Source: Mergermarket

Graph 17
China: Top 10 Sectors of completed M&A in EU countries by value
(2006-2023 ytd, USD bn)



N.B. Data of 2023 as of Feb.
Source: Mergermarket

It is also worth noting that China's greenfield investment in Europe is growing in importance, constituting 57% of the total in 2022 and up from just over 3% in 2014, according to the same report by Rhodium. The bulk of China's greenfield investment is in EV battery factories, with over €14bn invested through the five biggest deals since 2017 alone. More than half comes from CATL's 2022 investment of €7.6bn to build Europe's largest planned EV battery factory in Hungary. Based on the above, one could wonder whether the EU will manage to keep a resilient value chain in the EV space without becoming too dependent on Chinese battery makers, not only for imports but even for production in Europe.

2.2 Security and political issues

Although this testimony focuses on the economic aspects of EU-China relations, one must consider factors that go beyond or intersect with the economic to fully grasp the deterioration of relations. There are political issues, especially Russia's invasion of Ukraine, that must be held alongside purely economic considerations. Moreover, China's increasing presence in critical European infrastructure is becoming a focal point following the introduction of political sanctions and is affecting trade and investment relations.

2.2.1 China's presence in critical infrastructure

China's most relevant presence is in ports, primarily through companies like COSCO Shipping (the world's largest shipping company) and China Merchants Port Holdings (the sixth largest port terminal operator globally), but also Hutchison Port Holdings (a subsidiary of CK Hutchison Holdings, a private company headquartered in Hong Kong) which is the second largest port terminal operator in the world.[3] These companies operate container terminals and sometimes smaller inland ports in more than 10 European countries, with COSCO having full operative control of Piraeus, the port of Athens, since acquiring a majority stake in 2016.

China's ownership of European airports is limited and has come down in the last half-decade following a series of re-acquisitions by European entities. These include the takeovers of the airports of Toulouse[4], Frankfurt Hahn[5], and Tirana[6], but also the airport service-provider Swissport which was acquired by an international consortium of investors to bail out Chinese conglomerate HNA following a dive in revenues during the pandemic.[7] In the UK, China Investment Corp. holds a 10% stake in London Heathrow airport since 2012.[8]

One of the most contentious issues is China's participation in the European electrical grid. Chinese state-owned companies such as State Grid Corporation of China (SGCC) own large minority stakes in the national transmission system operators in 11 EU member states, with a particularly strong presence in Portugal, Italy, Greece, and Luxembourg.[9,10] Moreover, two Chinese companies own a joint majority stake in the renewable energy division of the Portuguese national grid operator Energias de Portugal (EDP) and are making inroads in the renewable energy sector in Spain.

Moving to nuclear energy, the most obvious case of critical presence is in the UK. In fact, China General Nuclear (CGN) has so far funded 33% of Hinkley Point C, a 3.2GW nuclear facility under construction and due to be finished in 2026.[11] However, CGN has been cut out of ownership structures of future nuclear power facilities following a turn in 2022. In the same vein, in 2020 CGN

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[3] Chinese strategic interests in European ports (Member's Research Service of European Parliament, 2023), https://epthinktank.eu/2023/02/28/chinese-strategic-interests-in-european-ports/

[4] https://www.france24.com/en/20191231-chinese-operator-sells-toulouse-airport-stake-to-french-company-for-€200m-profit-1

[5] https://www.aviation24.be/airports/frankfurt-hahn-airport-hhn/triwo-ag-takes-over-bankrupt-frankfurt-hahn-airport/

[6] https://www.tirana-airport.com/en/article/24/History-of-the-Airport#:~:text=As%20of%20December%2018%2C%202020,positioned%20in%20Albania%20and%20worldwide.

[7] https://www.swissinfo.ch/eng/business/chinese-owned-swissport-agrees-emergency-takeover/46003068

[8] https://www.heathrow.com/company/about-heathrow

[9] China's at the Gate of the European Power Grid, Groupe d'études géopolitiques (September 2021), https://geopolitique.eu/en/articles/chinas-at-the-gate-of-the-european-power-grid/

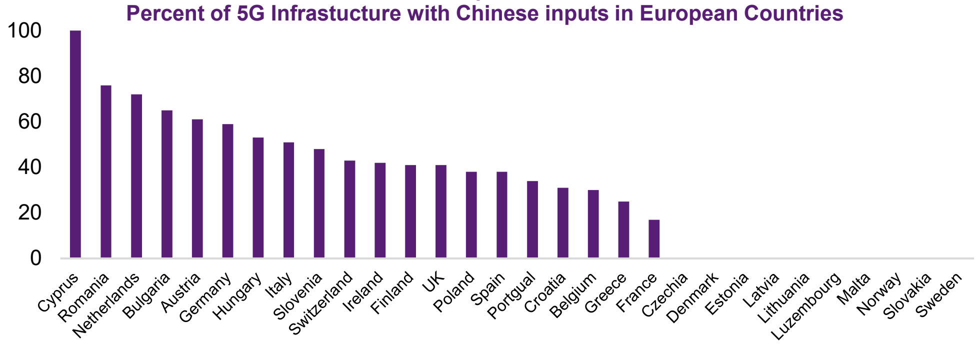
[10] https://www.enerdata.net/publications/executive-briefing/international-electricity-investments-europe.html

[11] Briefing: China's Involvement in UK Nuclear (5 July 2022), https://chinaresearchgroup.org/research/briefing-chinas-involvement-in-uk-nuclear-power

was outmaneuvered by the Romanian government over a deal to build two nuclear power plants in the country.[12]

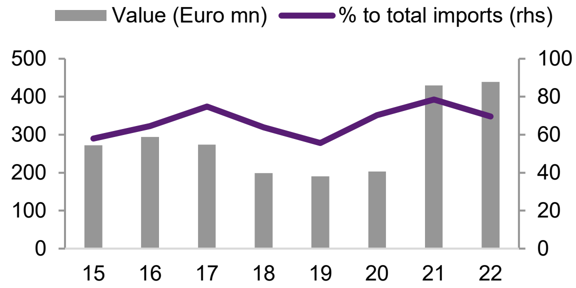
Telecommunications infrastructure has probably become the most sensitive issue among the different aspects of China's presence in European infrastructure and, in particular, 5G. In fact, Huawei is present in 19 EU member states and only a third of member states have banned the use of Chinese components in 5G infrastructure,[13] despite an EU agreement in 2020 to screen security risks in its 5G infrastructure (Graph 18).[14] In the same vein, imports of telecoms base stations from China have only increased since 2020 (Graph 19).

Graph 18
Percent of 5G Infrastucture with Chinese inputs in European Countries



Source: Strand Consult

Graph 19
EU's import of telecommunication base station from China



Source: Eurostat

Finally, sub-sea cables are also relevant critical infrastructure where China is making inroads. In particular, China is planning a $500mn undersea fiber-optic internet cable, known as EMA (Europe-Middle East-Asia), which will run from Hong Kong to Hainan before reaching Singapore, Pakistan, Saudi Arabia, Egypt, and France. This project aims at rivalling the US-backed $600mn program "SeaMeWe-6".[15] This is part of a

[12] https://balkaninsight.com/2020/05/27/romania-cancels-deal-with-china-to-build-nuclear-reactors/

[13] https://www.ft.com/content/a6900b0f-08d5-433d-bfb0-f57b6041e381

[14] https://www.ft.com/content/ee3f0764-41fc-11ea-bdb5-169ba7be433d

[15] https://www.reuters.com/world/china/china-plans-500-mln-subsea-internet-cable-rival-us-backed-project-2023-04-06/

broader Chinese initiative to build a new global subsea cable network to control future key Internet infrastructure.[16]

2.2.2 Sanctions and other retaliatory measures

As part of its autonomous measures, the EU imposed targeted sanctions on Chinese officials and entities over human rights concerns related to the treatment of Uighur Muslims in China's Xinjiang region.[17] These sanctions involved travel bans and asset freezes.

China retaliated against these targeted sanctions on 22 March 2021 by sanctioning 10 EU nationals and 4 EU entities, including Members of the European Parliament and of the Council's Political and Security Committee.[18] The consequences of such actions on EU-China economic relations and, in particular, on the EU-China investment agreement will be discussed later.

In addition, in December 2021, China curtailed virtually all Lithuanian exports into China, as well as Lithuanian elements of goods exported from other EU countries to China, notably Germany.[19] This decision came after Lithuania decided to open a Taiwan (and not Taipei) Representative Office in Vilnius in July 2021 after exiting the so-called “17+1” group.[20] The EU responded close to a year later by suing China at the World Trade Organization for imposing punitive trade restrictions on Lithuania. In addition, China’s coercion against Lithuania became instrumental in the EU Commission’s push for an EU-level Anti-Coercion Instrument (ACI) which was finally ratified on June 6, 2023.

Finally, since the Russian invasion of Ukraine, and the rather ambiguous role that China has played, Western sanctions against Russia have not been followed by China. Against this backdrop and based on the US and EU red line imposed on China that no arms will be delivered to Russia, the EU Commission proposed on May 8 2023 to blacklist several Chinese companies, on which no decision has yet been taken by the EU Council.[21]

3. Rollercoaster relations moving from autonomous trade measures towards de-risking

[16] https://www.datacenterknowledge.com/networks/what-chinas-major-submarine-cable-means-us-network-architects#close-modal
[17] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2021:099I:FULL&from=EN
[18] https://www.europarl.europa.eu/RegData/etudes/ATAG/2021/690617/EPRS_ATA(2021)690617_EN.pdf
[19] https://ec.europa.eu/commission/presscorner/detail/en/IP_22_627
[20] https://www.euractiv.com/section/china/news/lithuania-quits-divisive-china-171-group/
[21] https://www.reuters.com/world/eu-takes-aim-chinese-firms-third-country-exports-tighten-russia-sanctions-2023-05-08/#:~:text=BRUSSELS%2C%20May%208%20(Reuters),for%20the%20war%20against%20Ukraine.

While the downward trend in relations seems apparent, the way in which it is happening is not a precipitous descent but more like a rollercoaster ride, with the lowest point reached after Russia's invasion of Ukraine and the highest after French President Emmanuel Macron's recent visit to Beijing in April. Although Macron's accommodating stance toward China was widely discussed, the message delivered during the same official trip by the EU Commission President, Ursula von der Leyen, seems to have outlasted that of Macron. Her message was centred on the need for the EU to de-risk from China, as exposed in von der Leyen's speech prior to her official trip to Beijing, which highlights four aspects related to de-risking and that will be discussed later.[22]

3.1 A big carrot: the Comprehensive Agreement on Investment

After more than seven years and 35 rounds of negotiations, the European Union finally reached a deal with China on the Comprehensive Agreement on Investment (CAI) in December 2020. CAI was intended to replace 25 bilateral investment agreements between individual EU member states and China by offering greater market access within specific sectors. Ultimately, the goal was to reduce uncertainty for European investors in China by introducing more transparency regarding subsidies (actually only on services) and the general behaviour of Chinese state-owned enterprises (SOEs).

In the same vein, CAI aimed at opening some segments of the Chinese market to European foreign direct investment, mostly in line with concession that China had already made to the US under the Phase I deal. Beyond those targeted concessions, for electric vehicles and some health services, overall, the playing field remains tilted in China's favour. In fact, the small but relevant gains on market access were not accompanied by a clear improvement on investor protection as CAI only covers state-to-state dispute settlement pending the agreement on other forms of investment protection. This means that the existing infrastructure for handling financial disputes cannot be eliminated yet, namely the existing individual investment agreements between 26 EU member states and China.

Finally, while CAI includes some provisions on environment and labour rights protection, the conditions fall short of what has previously been agreed to in other investment or trade deals agreed by the EU which made the ratification at the European Parliament uncertain from the start. As if this were not enough, China's sanctions on some members of the European Parliament in March 2021 ended up in the EU Parliament's decision to refuse any discussion on CAI until these sanctions were lifted. Since then, CAI is pending ratification and the prospects that the situation changes any time soon are quite slim.

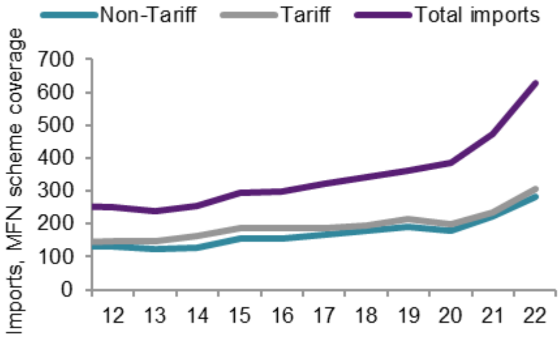
3.2 A set of sticks: the EU autonomous measures

[22] https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063

As the EU was moving towards the negotiation of CAI, the environment changed radically, first externally, as the Trump administration started its trade war with China but also with a huge surge of Chinese investment into European companies, many of which in strategic companies as well as much harsher competition in third markets supported by China's bold industrial policy based on massive subsidies.

While the EU has stepped up the use of autonomous measures to deal with non-market economies, it is important to note that the EU has not followed the US in terms of raising tariffs on China, as is shown by the share of tariff versus non-tariff EU imports from China having remained the same notwithstanding the large increase in total imports (Graph 20).

Graph 20
Zero vs. non-zero tariffs on EU normal imports from China (EUR bn)



Source: Eurostat

Beyond tariffs, the EU Commission has developed a number of autonomous measures (Table 2). One key example, also because of how it may have been influenced by the Committee on Foreign Investment in the United States (CFIUS), is the EU Foreign Direct Investment Screening Regulation, which came into effect on October 11, 2020 and which has for its scope to review both acquisitions and investment from outside the EU in any strategically relevant.[23] This is no more than a coordination device among Member States and the Commission, which can then issue opinions and recommendations. These, however, are not binding as the individual Member State has the final decision. It should also be noted that Member States often have distinct screening mechanisms, with 18 out of 27 Member States having one in place at the moment.[24]

Table 2: Some of the EU autonomous measures

Measure	Date
Anti-dumping regulation	Jun 2016
Foreign investment screening mechanism	Oct 2020
Foreign subsidies regulation	Jan 2023

[23] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867
[24] https://circabc.europa.eu/ui/group/be8b568f-73f3-409c-b4a4-30acfcec5283/library/7e72cdb4-65d4-4eb1-910b-bed119c45d47/details

Anti-coercion instrument	Jun 2023
Corporate Sustainability Due Diligence Directive (CSDD).	Jun 2023

Source: The EU Commission, Bruegel

In 2022, there were at least 16 publicly disclosed screenings of Chinese investments into the EU and the UK, of which only 4 were ultimately cleared and the rest were either blocked or annulled, or the offer collapsed or was withdrawn.[25] Two attempted investments into the EU semi-conductor industry were blocked. The only two publicly screened cases that were ultimately permitted in the EU were an investment into the Italian robotics company Robox, subject to a prohibition of technology transfer, and an increased equity stake in the Tollerort container terminal in Hamburg, subject to restrictions.

3.3. De-risking

The EU Commission's move from carrots and sticks to de-risking needs to be understood as a response to major events: one mostly political but a second one which is mostly economic. The first is Russia's invasion of Ukraine and its implications for the "Weltanschauung" of European leaders. Not only have these leaders all of a sudden had to become more geopolitical, but they have also realized that Russia and China share more in common than previously understood. The second reason, more economic, is the EU's increasing dependence on China for its energy transition, which naturally brings back bad memories about the EU's (and specially Germany's) excessive dependence on Russian gas.

The basic idea behind the EU's de-risking strategy was set out in the speech Commission President von del Leyen delivered right before her trip to Beijing in April.[26] A first important point in her speech is the acknowledgment that decoupling from China is neither viable, nor in the EU's interest. However, she considers economic de-risking after the "diplomatic" de-risking, which has been accelerated by Russia's invasion of Ukraine. Von der Leyen's call for de-risking is based on four pillars. The first is about the EU economy itself, which needs to become more competitive and resilient, through industrial policies or other means, and in particular as regards health, digital and green technologies. The net zero industrial act (aiming at 40% of the clean tech being produced in the EU) is the key instrument pushed by the commission for this goal together with the Critical Raw Material (CRM) Act. The second pillar is a better use of existing trade-related autonomous measures but also mentions elevating them to cover sensitive high-tech areas such as microelectronics, quantum computing, robotics, artificial intelligence and biotech. In the same vein, she mentions the need to reflect on a potential new instrument, namely that of outbound investment screening to limit the transfer of sensitive technologies to China.

[25] https://rhg.com/research/chinese-fdi-in-europe-2022-update/
[26] https://ec.europa.eu/commission/presscorner/detail/en/speech_23_2063

This should be part of the EU new Economic Security Strategy to be unveiled by the EU Commission in the next few days.

The above shift towards de-risking came against the backdrop of a rather strong message by numerous EU heads of state against decoupling from China, including German Chancellor Scholz, during his official visit to Beijing in November 2022. To understand what prompted the EU Commission, and in particular von der Leyen, to push for de-risking, it is important to understand what might not have gone well with the EU's previous strategy. In fact, the EU's three-pronged approach to relations based on carrots and sticks was meant to achieve cooperation while reducing competition and, especially, rivalry. In reality, cooperation has been much harder to achieve than expected and competition is stronger than ever, with rivalry in some areas. This has become more apparent after the exchange of sanctions, China's coercion against Lithuania and, particularly, since Russia's invasion of Ukraine and China's ambiguous position in this regard. Below is an account of the big carrot and several sticks until reaching the current stage of de-risking.

It is still uncertain how the EU will continue to develop its own idea of de-risking and how it will compare with that of the US administration but it seems important to reflect on the fact that both the US and the EU seem to be heading in the same direction but on parallel venues without due account of each other.
This might not be the best way to achieve a common goal, namely that of de-risking from what is becoming an increasingly pervasive dependence from the Chinese economy. As such, a proposal for coordination follows.

4. Policy options: coordinated specialization and trade agreements

Moving from existing measures to policy options, it is important to realize that not only the EU is benefitting less from its economic relations with China, but other countries too. At the same time, the world is confronting a major challenge, namely that of decarbonizing, which requires global cooperation. Against this backdrop, the EU to de-risking from China unilaterally, without taking due account of the actions taken by the US or other countries, does not seem to be the best option. A good example of the potential tensions that such unilateral actions may entail is the Inflation Reduction Act introduced by the US and its impact on the European Union, which also explains the EU's quest for industrial policy, especially as regards the securing of critical raw materials under the CRM.

A better solution, in my view, would be to opt for <u>coordinated specialization</u> in which a number of like-minded countries would decide to pool resources in four key areas: (i) access to critical raw materials and (ii) their refining, (iii) green-energy related innovation as well as the transfer of new technologies in the field, and, finally, (iv) manufacturing of solar panels, EV batteries and wind turbines. Such coordinated specialization should be a safer, and cheaper, bet to create an alternative ecosystem in terms of green energy as countries within the ecosystem would not need to compete among themselves with subsidies or other forms of protectionist measures.

This parallel ecosystem should actually be welfare-enhancing globally as nobody is better off when depending on a single source for its energy transition, not even China. In fact, any unexpected event in China, including an environmental catastrophe or a new pandemic, if today's high dependence on China were to persist, could seriously delay the decarbonization efforts of all countries in the world including China itself. In addition, concentrating as much as 90% of the production of a specific green energy sector may lead to technological path-dependence, which may impede the development of more effective technologies.

This is why moving towards coordinated specialization to create an alternative ecosystem of procurement of raw materials, innovation and production seems like a good way forward for the EU but also the US and the world as whole, including China.

Finally, de-risking while decarbonizing through coordinated specialization is a potential solution, it does not address the challenges related to the EU's quest to remain competitive in third markets, which is complicated by China's massive deployment of industrial policy. In fact, China's sheer size means that its industrial policy has major global effects. The EU has learned this the hard way in the case of solar panels and, more recently, electric vehicles. Against this backdrop, a coordinated response to China's non-market-driven competition seems like a better option than piecemeal responses by like-minded countries.

Finally, on the trade front, while the EU has stepped up its efforts to sign new trade and investment deals, the progress is still slow, especially for major economies in Asia. To accelerate this process and offer a clear signal that the EU is back for business, it seems important to follow the United Kingdom in its recent accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTTP). While the EU Commission does not appear keen to pursue this route, given its long-standing role as broker of its own trade and investment deals, I am convinced that the signalling effect of being part of CPTTP would be extremely important for Asia and the Pacific. This would be even more the case if the US were to follow the same path.

5. Conclusions

EU-China relations are going through sharp gyrations, but the trend is clearly not positive. This begun in 2019, especially since the start of the pandemic and, even more so, since Russia's invasion of Ukraine. This reality is not as related to the US as some analysts may think, especially from Beijing's perspective. But it is an unmistakable signal of the EU's awareness of the diminishing economic benefits of its relations with China, beyond other important political and value-based considerations.

Given the EU's increasing dependence on China for its energy transition, the need to re-risk is now at the forefront of its policy discussions. The EU's understanding of de-risking does not seem to be the same as that of the US, since it is meant to be more targeted and mainly focused on the ability to secure critical raw materials for the EU's own supply-chain of green energy manufacturing. In addition, the US has become increasingly wary of its own industrial policy without paying due account to the EU's position.

Given the above, my proposal would be to push de-risking at a multilateral level. In fact, rather than carrying out different strategies of de-risking in an uncoordinated manner, I would advocate for <u>coordinated specialization by a group of like-minded countries</u> as a way to reduce excessive dependence on China's monopoly over the sourcing of green energy. This proposal clearly does not solve all the economic issues that the EU is piling up as far as China is concerned, but it could be a good starting point.

A second proposal is to continue to expand market access to the fast growth-region in the world, namely Asia. The simplest way to do so would be for the <u>EU and the US to follow the UK in applying to join the CPTTP.</u> The latter should be considered as an important signal that the West is open for business and considers the Pacific as a very important part of its economic strategy, not only its security strategy.

Finally, <u>while defensive measures–such as the chips ban or outbound investment screening–might be needed, they will not be enough without offensive measures centred on reducing the dependence on China for the green transition and in increasing trade and investment with the rest of the world, in particular the Global South.</u>