EU–China relations at a crossroads, Vol. II: Decoding complexity, mitigating risk

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The context of EU–China relations has dramatically changed over the past years. The many opportunities that cooperation with China presents are only one side of the coin. Mounting challenges and diverging perceptions on and approaches to global and domestic affairs risk undermining the effectiveness of the bilateral dialogue. It is crucial to minimise all misperceptions and overcome any lack of understanding in the EU–China bilateral relationship, now more than ever.

The EU & China Think-Tank Exchanges project, coordinated by the European Policy Centre (EPC) with the cooperation of EGMONT–The Royal Institute for International Relations, the China Institute of International Studies (CIIS) and the Center for China and Globalization (CCG), aims to strengthen and stimulate a dialogue between think tanks and research institutes across the EU and China.

Over a period of three years, the EPC and its think tank partners encourage experts, analysts and policymakers from Europe and China to discuss issues of common interest, such as post-COVID-19 cooperation, climate action and the environment, the global economy, digitalisation and connectivity, human rights and peace, or security in international affairs.

Through a series of structured exchanges between intellectuals and strategic thinkers, the project promotes EU–China dialogue and supports mutual understanding and joint action across several relevant and cross-cutting policy areas and issues of mutual concern.
The European Policy Centre (EPC) is an independent, not-for-profit think tank dedicated to fostering European integration through analysis and debate, supporting and challenging European decision-makers at all levels to make informed decisions based on evidence and analysis, and providing a platform for engaging partners, stakeholders and citizens in EU policymaking and in the debate about the future of Europe.

The Europe in the World (EiW) programme scrutinises the impacts of a changing international system on Europe and probes how the EU and its member states can leverage their untapped potential to advance their interests and values on a regional and global level. It thus examines the evolution of EU relations with major powers, such as the US, China and Russia, and how Europe can contribute to a rules-based global order. Second, the programme focuses on the role of the EU in fostering reforms, resilience and stability in neighbouring regions. It looks closely at the developments in Turkey and Ukraine. Third, the programme examines how the EU can strengthen its security in the face of terrorism, jihadist radicalisation or hybrid and cyber threats. It also seeks to advance the debate on Europe’s defence policy.

EGMONT – The Royal Institute for International Relations is an independent think tank based in Brussels. Its interdisciplinary research is conducted in a spirit of total academic freedom. Drawing on the expertise of its own research fellows, as well as that of external specialists, both Belgian and foreign, it provides analysis and policy options that are meant to be as operational as possible.

Benefiting from the role of Brussels in the global arena and from the prestigious setting of the Egmont Palace, the Institute offers an ideal forum to visiting heads of states and government, representatives of international organisations, foreign ministers and other political figures. Conferences, colloquia and seminars nurture the work of the research fellows. They also give participants the opportunity to exchange views with other specialists and with a well-informed public made up of representatives of the political, economic and academic spheres, the media and civil society.

Along with research and meetings, the Institute has also developed specialised training activities, both in Brussels and abroad. It can, on request, offer specific programmes for visiting and resident diplomats and foreign professionals. Close cooperation with other research centres, both in Belgium, in Europe and beyond, has resulted in a growing number of joint conferences and in more structured cooperations on research and publications. This has proved to be mutually beneficial and enriching.
The **Center for China and Globalization** (CCG) is a leading Chinese non-government think tank based in Beijing. It is dedicated to the study of Chinese public policy and globalization. Boasting a strong research team, it enjoys an impressive record of publications and events with broad public policy impact. CCG’s research agenda centres on China’s growing role in the world, drawing from issues of global governance, global trade and investment, global migration, international relations, and other topics pertaining to regional and global development.

The CCG was founded in 2008. Today, nearly 100 in-house researchers and staff serve this thinking hub with subsidiaries and divisions spanning across China, including Shanghai, Shenzhen, Guangzhou, Qingdao and Hong Kong.

CCG is a not-for-profit and non-governmental organization, independently funded by research grants and donations from private and corporate donors. The think tank is supported by a business advisory council that consists of over 150 Chinese private entrepreneurs. Many prominent Chinese private business leaders, such as Cao Dewang, Ronnie Chan, Wang Shi, Wang Junfeng, Robin Li, Jiang Xipei and others currently serve on the executive committee of the CCG advisory council. For years, CCG has been ranked by the Think Tank and Civil Society Program (TTCSP) at the University of Pennsylvania as one of the world’s top 50 independent think tanks.

The **China Institute of International Studies** (CIIS) is the think tank of China’s Ministry of Foreign Affairs. It conducts research and analysis primarily on medium- and long-term policy issues of strategic importance, particularly those concerning international politics and the world economy. It also carries out studies and offers policy recommendations on major events and pressing issues.

The staff of CIIS consists of nearly one hundred researchers and other professionals. Among them are senior diplomats, leading area-study specialists, and pre-eminent experts in major fields of foreign affairs. Young scholars at the CIIS all have advanced university degrees in international relations or related disciplines.

CIIS has its own professional library, which is home to over 260,000 books. The collection on international affairs is among the best in the country. **International Studies** is the bimonthly journal of CIIS, which provides an influential forum for the discussion of important international issues. Its contributors include CIIS researchers and outside foreign affairs experts. The English-language journal **China International Studies**, which is another leading journal of CIIS, is the first English academic publication in China on diplomacy and international politics for formal circulation.
I am very pleased to present the second compendium “EU-China relations at a crossroads, Vol. II: Decoding complexity, mitigating risk.” This work once again combines the thinking of scholars from Europe and China on the critical questions facing EU-China relations. The EU’s continued support for this project derives from its firm belief in the necessity of dialogue and face-to-face contact between scholars and think tanks in order to build trust, enhance mutual understanding, and ensure a more enduring EU-China relationship.

The keywords reflected in the following pages indicate the challenges we are facing today: comprehensive national security, nationalism, de-coupling vs de-risking, geopolitics, war, and global crises. The creeping pervasiveness of power politics and all-encompassing security over multilateralism and international law creates obstacles to cooperation and brings back painful memories from the past.

A more mature and resilient relationship starts with fostering close and trust-based people-to-people connections that nurture candid dialogue and bring about a deeper understanding of each other. This compendium is a step forward on this path. The exchanges and dialogues that have led up to its creation have brought about a leap. With the doors of China opening again after the passing of the COVID-19 pandemic, I look forward to seeing a busy calendar for European scholars travelling to China and vice versa to truly embark on reversing the thickening wall of misunderstandings.

I hope the conversation will continue with active engagement on both sides and a mutual willingness to listen and understand.

Jorge Toledo Albiñana
EU Ambassador to China
Beijing, June 2023
It is a privilege to contribute the preface to this second volume of compendium contributions on EU-China Relations at a Crossroads. The work that has been, and is being, undertaken under the EU & China Think Tank Exchanges project is of great value as the European Union and China seek to chart a sustainable and mutually beneficial forward path in their bilateral relationship.

The insights of both Chinese and European scholars found in these pages should serve to enhance mutual understanding, as we collectively seek to maximise mutual trust, optimise the scope for continued cooperation and minimise the scope for misunderstandings and misperceptions.

China and the European Union have changed greatly in the 20 years since the first EU-China Comprehensive Strategic Partnership was launched in 2003. The world situation has changed also, in radical and at times unforeseen ways as the pandemic in particular attests.

Successive challenges have come thick and fast. War, the risk of further conflict in different parts of the globe, the existential challenges posed by climate change, the growing burdens faced by many in the developing world, critical issues of health, increasingly contested conceptions of global political, trade and economic governance - all of these challenges also point to the need for sustained reflection on how to develop the EU-China relationship to solid mutual benefit.

This volume thus appears at a particularly important confluence of events when major geopolitical shifts are in motion. It is important not only to seek to understand these shifts and their causes but also to work to identify their implications for EU-China relations. Dialogue and face to face interaction should be an essential part of this work.

These volumes, and the papers they contain, with their thought provoking recommendations and conclusions, provide not only valuable assessments of the issues under consideration but also a rich set of agendas for future consideration and debate.

I would like to thank sincerely all of the contributors for their thoughtful and forward looking contributions, and for so fully illuminating some of the waypoints and coordinates which will help us all to continue to chart a path forward on EU-China relations.

I warmly acknowledge and thank on behalf of the European Policy Centre our think tank partners - Egmont (The Royal Institute for International Relations), the Center for China & Globalization (CCG), and the China Institute of International Studies (CIIS) - for their continuing cooperation and commitment to our mutually enriching exchanges and dialogue.

Finally, I wish to thank the many members of the European Policy Centre team who contributed to the preparation and completion of this Volume. I offer a particular word of warm thanks to Ivano di Carlo and the Europe in the World team for their continued efforts in making this project a great success.

Declan Kelleher
Chair, Governing Board
List of acronyms

AI  artificial intelligence
AIIB  Asian Infrastructure Investment Bank
AfCFTA  African Continental Free Trade Area
APEC  Asia-Pacific Economic Cooperation
ASEAN  An intergovernmental organisation of ten Southeast Asian countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.
API  active pharmaceutical ingredients
B3W  Build Back Better World
BIT  Bilateral Investment Treaty
BRI  Belt and Road Initiative
CAI  Comprehensive Agreement on Investment
CAICT  China's Academy for Information and Communications Technology
CATL  Contemporary Amperex Technology Co., Limited
CBAM  Carbon Border Adjustment Mechanism
CCCEU  China Chamber of Commerce to the EU
CCG  Center for China and Globalization
CDC  Center for Disease Control and Prevention
CIIS  China Institute of International Studies (CIIS)
CMIA  Chinese Medical Informatics Association
COP  Conference of the Parties
CPTPP  Comprehensive and Progressive Trans-Pacific Partnership
CRMA  Critical Raw Materials Act
CSRD  Corporate Sustainability Reporting Directive
DEPA  Digital Economy Partnership Agreement
DMA  Digital Markets Act
DSA  Digital Services Acts
DTS  Digital Technologies Stack
D20  International Data Alliance
ECB  European Central Bank
ECDC  European Centre for Disease Prevention and Control
EiW  Europe in the World
EPC  European Policy Centre
ESG  environmental, social and governance
ESPA  Economic Security Promotion Act
ETS  Emissions Trading System
EUCCC  European Union Chamber of Commerce in China
EWRS  European Union Early Warning and Response System
FDI  foreign direct investment
FSR  Foreign Subsidies Regulation
FTA  free trade agreement
GHG  greenhouse gases
GIIB  Global Infrastructure Investment Bank
GDP  Gross Domestic Product
GDPR  General Data Protection Regulation
G20  Group of Twenty
HERA  European Health Emergency Preparedness and Response Agency
HPC  High-performance-computing
HSC  Health Security Committee
IEA  International Energy Agency
IHR  International Health Regulations
IMF  International Monetary Fund
IPEF  Indo-Pacific Economic Framework
IPR  Intellectual Property Rights
IRA  Inflation Reduction Act
IT  Information Technology
JOGMEC  Japan Oil, Gas and Metals National Corporation
MC12  Twelfth Ministerial Conference
MDB  multilateral development bank
M&As  mergers and acquisitions
MiC25  Made in China 2025
NZIA  Net Zero Industry Act
PPE  personal protective equipment
RCEP  Regional Comprehensive Economic Partnership
R&D  research and development
SOEs  state-owned enterprises
TTC  Trade and Technology Council
TTCSP  Think Tank and Civil Society Program
UMSCA  United States – Mexico – Canada Agreement
UNFCCC  UN Framework Convention on Climate Change
WTO  World Trade Organization
What factors are pushing the EU to re-evaluate its economic exposure to China? What measures has the EU taken to enhance its supply chain resilience? What initiatives has the EU adopted to ensure the security and reliability of critical supply chains? What are the main strategic dependencies that the EU currently faces in its relationship with China in the digital and technology domains?
The renewed push for supply resilience should not create illusions about the need for a form of free trade

Francesca Ghiretti
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Introduction

Whether we call it supply resilience or supply security, measures to make the supply of goods and services less exposed and vulnerable to disruptions are growing in number and intensity. First, the COVID-19 pandemic highlighted the shortcomings of global supply chains and made a convincing case for their shortening. Then came the spotlight on the use of forced labour in the production of textile and technological components in Xinjiang, which contributed to shaping the issue of human rights and labour rights in our products’ supply chain. Finally, the war in Ukraine and Russia’s subsequent cut of gas supplies to Europe left no doubt about the need to better manage dependencies in European supplies.

Key issues

China’s use of economic coercion is another element that contributed to raising awareness over the issues of vulnerabilities in the supply chain. The use of economic leverage to signal discontent and punish Lithuania for opening a permanent representation of Taiwan in Vilnius was not the first or only episode of Chinese economic coercion against Europe. However, China’s response did not limit the supply of Chinese components to Europe as much as it reduced European supplies to China. Nonetheless, this episode contributed to the European conversation regarding the resilience of its supply chains. If a country can easily decide to suspend a chosen form of economic interaction, what protects Europe against future supply disruptions?

Elsewhere, countries have long been dealing with the issue of economic coercion and elaborating possible solutions that include enhancing the resilience of their supplies. Australia, Japan, South Korea, and Taiwan have long been subject to different forms of Chinese economic coercion and connected disruptions, which have contributed to shaping their policies in favour of supply resilience.

Furthermore, a potential scenario of an escalation in the Taiwan Strait provides an undesired yet realistic instance of global supply chain disruptions. The high degree of dependence that the EU and other countries’ supply chains have on China further fuels these concerns. At the same time, China displays concerns regarding the resilience of its supply chains.

CHINA’S CONCERNS ABOUT SUPPLY RESILIENCE

China has been signaling its concerns regarding the resilience of supply long before COVID-19 erupted and reached Europe. Often, the policies adopted by China to address such concerns have come with a strong self-
sufficiency component, not in the sense of complete autarchy, but as progressively the goods and services considered strategic or fundamental for national security at home. With one caveat: the understanding of what is strategic and what national security entails is undergoing continuous expansion.

Famously, the strategy of Made in China 2025 (MiC25) released in 2015 embodied such an ambition, and the evolution of the policy into the dual-circulation economy launched in 2020 sealed the concept. These strategies left little doubt over China’s focus on securing its resilience and supplies against external disruption. They also aimed to increase the rest of the world’s reliance on the Chinese market, which is no less problematic for the European economy, considering China’s inclination to use economic ties as leverage to punish or influence policymaking.

Internally, China has also adopted targeted measures to enhance its supply resilience. Most significant is the subsidisation of strategic industrial sectors such as batteries, semiconductors, and technologies for the green transition. These approaches have often included the transfer of knowledge from foreign actors to mitigate China’s weaknesses, but also policies to protect its strategic industries and the technological advantages gained in such industries, such as the Foreign Investments Law and the Export Controls Law. The latter embodies Beijing’s concerns regarding the disruptions that foreign sanctions could bring to China’s economy by attempting to create a legal framework to protect China in the event of “discriminatory measures against Chinese citizens/interference with China’s internal affairs.”

The Belt and Road Initiative (BRI), officially introduced in 2013, also contained fundamental elements for boosting supply resilience. Beyond the well-known developmental aspect that underpinned the BRI, the initiative helped China build relationships and secure economic ties with a number of countries, which often included agreements for the supply of materials and/or services that China did not possess. This enabled a strengthening of China’s supply resilience that continues to be effective ten years later.

OTHER GLOBAL ACTORS ARE ALSO ADOPTING ELABORATE MEASURES

The EU first assessed its strategic dependencies in 2021, followed by a second in-depth evaluation of five areas of dependencies in 2022, including rare earth, chemicals, solar panels, cybersecurity, and IT software. Unsurprisingly, China features as the main source of the EU’s strategic dependencies and vulnerabilities to disruption. The follow-up report’s publication coincided with broader efforts at building supply chain resilience in the common market, such as through the EU’s Chips Act (December 2022) to boost local production of semiconductors and the Battery Regulation, which creates requirements for the recycling of battery components such as cobalt, lead, lithium and nickel. This also came just before the 2023 proposal of the Critical Raw Materials Act, which aims to strengthen EU supplies. The Critical Raw Materials Act may then be further strengthened by a potential trade agreement between the EU and the US on critical minerals. Now, it appears the European Commission is also considering a similar regulation for active pharmaceutical ingredients (API) for which the EU is heavily dependent (22.7% of all imports) on China.

In the meantime, the EU has also been developing regulations for due diligence of supply chains that take into account violations of human rights and a policy against the use of forced labour in the EU’s supply chains. Testament to the EU’s concerns over economic disruptions caused by coercion, the EU is working on the adoption of an anti-coercion instrument. Initially created to respond to the coercive approaches from the Trump administration, in the past years, the instrument has been viewed as possible means to respond to China’s use of economic coercion.

South Korea has been identifying over-dependencies in supplies from foreign countries with a quantitative focus. For example, if Korea’s dependency on a specific item is 50%, it will monitor the item and include it in a list of items for an early warning system in case of supply disruption. The EU is also designing an early warning system for strategic items.

So far, South Korea has identified around 4000 items, and it has been further expanding the criteria for the assessment, adding another 200 items. The full list is not publicly available as Seoul prefers to plan how to manage such vulnerabilities (i.e. stockpiling and diversification) without advertising them. Furthermore, South Korea’s Chips Act introduces state support to the domestic semiconductors industry, which at the moment is led by Samsung and SK. South Korea is in the process of making a basic law to support supply chain stability and businesses’ stable supply. The law also includes financial assistance to companies to help them make their supply chains more resilient. It includes tax incentives; feasibility assessment of projects for chipmaking; and indirect investments in companies that show promise, including preventing trade secrets theft. Seoul has also recently adopted the Act on Prevention of Divulgence and Protection of Industrial Technologies, which includes a form of screening for investments abroad in the interested sectors.

Japan’s Economic Security Promotion Act (ESPA) presents four main policy issues: “ensuring the stable supply of critical items”, “ensuring the stable provision of essential infrastructure services”, “enhancing the development of advanced critical materials”, and “non-disclosure of selected patent applications”.

It sets up a process and structure to guarantee the four elements above, which strongly focus on supply chain security while safeguarding home-grown innovation. The ESPA includes a six-step item-specific process...
to ensure the security of supply of the critical items identified:

(i) Designation of critical items by the cabinet office.

(ii) Elaboration of an action plan for each item.

(iii) Formulation of an operation plan by the companies.

(iv) Application by the companies to the government.

(v) Government approval.

(vi) Funding.

Japan Oil, Gas and Metals National Corporation (JOGMEC) has been playing a significant role in the supply chain security of rare earths, among others. JOGMEC provides financial support for the exploration and development of resources, carries out research and development (R&D), and operates stockpiling programmes. These activities are based on a law concerning the Japan Oil, Gas and Metals National Corporation.

Main challenges and opportunities

CHALLENGES IN SUPPLY RESILIENCE

Enhancing supply resilience is a reasonable response to growing uncertainties in the practices and un/official rules of globalisation. Ideas like friend-shoring, the US-led Mineral Security Partnership, or the supply chain pillar of the Indo-Pacific Economic Framework (IPEF) try to mitigate the protectionist involution that such practices might lead to and prevent a scenario where each and every actor goes for self-sufficiency and attempts to produce on its own anything that it has decided to be strategic or essential. If China used to be one of the few to bring forward this policy, now it is one of the many. We have already seen such a dynamic in action, with a growing number of actors adopting unilateral or multilateral frameworks and/or policies to enhance the resilience of their supplies.

However, these strategies still carry three fatal flaws. First, these groupings tend to be exclusive and formed by few advanced economies, thus, reinforcing the division between advanced and developing countries. Securing supplies is also a geopolitical game that cannot be won without collaborating with developing economies. Second, policies on making supply chains more resilient tend to focus too much on diversification as a solution that can solve all the problems. It cannot. Without losing sight of the importance of diversification, more attention should be paid to recycling, options for stockpiling, and a conversation with the population on the need to change consuming patterns. If the policies the EU and other countries adopt will work, commodities will likely become more costly, but this is not being communicated properly to the population. Third, unlike the US or China, the EU cannot afford a protectionist turn. Much like South Korea and Japan, the EU cannot be fully self-sufficient in the production of the necessary commodities. Therefore, it must constantly strive to preserve forms of rules-based collaboration with other countries and keep protectionist ambitions under check.

Policymaking to better safeguard the resilience of supplies has unlocked a rethinking of subsidisation in market economies. A long-practised approach in a relatively centralised economy such as China, subsidisation is one of the solutions to what may be an expensive and unnatural process for market economies: making supplies more resilient. Subsidisation allows targeting economic areas considered strategic, in theory softening the cost of change for the companies while increasing the success of the attempt. For example, Europe’s weakness in chips production would hardly be overcome by the action of private enterprises alone, hence why the EU adopted the Chips Act to boost investments in the sector, increasing the chances of making the European supply of chips more resilient. However, the alleged success of China in adopting subsidies for targeted industries often leads to hasten conclusions. Industrial policies do not always work, not even for a China that, in theory, poured large capital into it. Therefore, industrial policies should be adopted with a phased approach and continuous assessment of progress to avoid the issuance of funds that do not lead to the much-needed results.
Recommendations and conclusions

Ultimately, without a major shock, companies will not leave risky but still fruitful markets like the Chinese one. The enthusiasm and deepening of the commitment in China of certain enterprises that followed the reopening of China after years of zero-COVID policy is a testament to that. However, this should be taken as an opportunity rather than a weakness. Increasing the resilience of supplies means being able to maintain an acceptable supply level in case of disruption. Rather than advocating for companies to leave the Chinese market, we should advocate for companies to identify their level of exposure to the Chinese market, be transparent about it, and find alternatives and strategies to increase resilience while remaining in this market. Be assured, the Chinese have been taking this approach to ensure a plan B is viable in case of disruptions such as sanctions from the US.

One point often raised by companies is that supply chains are so complicated that businesses cannot possibly know all the components involved in them. On the one hand, this is a fair point not only because in countries like China, objective and reliable auditing is an almost impossible exercise – made probably even more impossible by the newly adopted law on counter-espionage – but also because, already at tier three, we may be talking about millions of suppliers. On the other hand, legal frameworks already exist regarding due diligence of supplies in areas such as money laundering, terrorism financing, human rights violation and environmental impact. Companies are required to apply those to the best of their capabilities, and the same should happen with the exposure of their supply chains.

In conclusion, enhancing supply chain resilience should not become a vow to self-sufficiency. If anything, China shows that the quest for self-sufficiency is long, full of hurdles and costly. Even as the second-largest economy in the world, events like a sudden pandemic may still leave you in need of economic connections with other countries. As for Europe, in a scenario where the “newly” discovered mine in Sweden will be able to provide Europe with a share of the needed rare earth - an area of weakness for the continent – the bloc remains highly dependent on imports and with little capacity to become self-sufficient in the production of the commodities it needs. As such, even though the idea of a short-cut solution to the diversification of supplies amongst a grouping of selected countries may be attractive, the truth is that Europe must keep advocating for free trade as much as possible. That said, operating by risk profiling countries would be a clever way forward to avoid deepening dependencies on actors that carry high levels of risk and be able to prioritise the preparation of contingency plans.

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Europe’s strategic dependencies on China: The digital domain

Introduction

Policymakers in Europe are increasingly concerned with the mounting strain on the existing liberal international order and the shifting geopolitical centre of gravity to the Indo-Pacific, and in particular, China. Technologies play a crucial role herein: the digital revolution is profoundly changing the way in which people live and interact, and technologies are a defining element of the economic and strategic competitiveness of all countries.

This paper highlights paths of action to deal with the main strategic dependencies the EU has in its relationship with China, focusing on the digital and technology domains, within a short- and medium-term timeframe. Better understanding of Europe’s dependencies and how to address them is sought through an analytical framework that distinguishes between three courses of action, namely: promote, shape & regulate, and protect. These actions are embedded in each layer of the so-called Digital Technology Stack (DTS). The Stack is an established model that unpacks the totality of a country’s technological capabilities, including hardware, software, and services. Adapted to encompass technological and non-technical components, the DTS helps to unveil dependencies in each layer of the Stack, which may be addressed through the promote-shape-and-protect line of action. This paper is an initial attempt to unveil such dependencies using this comprehensive framework.

Better comprehension of Europe’s strategic dependencies in all layers of the DTS can contribute to the whole-of-government approach that is needed to tackle the interconnected economic, political and security challenges. After all, the challenges facing the EU and its member states in this era of geopoliticisation of the technological and digital field cannot be solved only by specialists, who tend to have a primarily technical view on sub-sets, whether that is the digital market, the semiconductor business, secure supply of minerals or internet governance.

Avoiding dependencies is about ensuring choice at each layer of the DTS. Improved understanding of this will contribute to better policymaking and greater EU unity, strength, and resilience. All of these are prerequisites to promote Europe’s interests successfully in its relationship with China.

Key issues

FROM OPENNESS TO CONDITIONAL ENGAGEMENT

The EU and China have developed increasingly deeper economic ties since the latter acceded to the World Trade Organization (WTO) in 2001. The mutual economic dependence has grown since, supported by agreements like the EU-China strategic partnership initiated in 2003 and the 2014 Comprehensive Strategic Partnership for mutual benefit. In 2021, China was the biggest EU trading partner overall, the top exporter country to the EU and the bloc’s third biggest market.

However, the EU and its member states started to put limits on the openness of their economies to China because of the hardening Sino-US competition over technological supremacy that erupted in 2017. Policies to protect EU markets against unwarranted...
investments – including in high-tech sectors and critical infrastructures – and to reduce strategic dependencies are underway at the EU and member-state levels. ‘Systemic rivalry’ became the accepted term and reasoning for investments from Europe to third countries. The Global Gateway became the flagships initiative of a European agenda that seeks to "build partnerships, not dependencies". Concerns about China are the main drivers of Europe’s changing course.

The overall trade balance in goods is favourable to China, whose exports to the EU more than double its imports. Nevertheless, trading countries like Germany, the powerhouse of the European industry, are particularly reliant on exports to China, which has become its main trade partner since 2015. Differences among the EU member states’ ties to China are a key reason for diverging opinions on how the so-called ‘open strategic autonomy agenda’ ought to be implemented, as well as how the European block should manage its overall relationship with China. The visit by German Chancellor Olaf Scholz to Chinese President Xi Jinping in November 2022 raised concerns with many, both within his government and in Europe. They regarded it as a repetition of the same mistakes that led to (over)dependence on Russia, another unreliable authoritarian partner.

Such concerns may be explained by the paradigm shift that is ongoing in Europe, away from the market-based, open economy thinking that has dominated policy circles in the past decades. The new direction is towards a geostrategic, more closed economy thinking, with a shift from a focus on trade to one on technology.

Three main triggers contributed to this paradigm shift, each with specific effects on the geopolitics of technology and digitalisation. The hardening competition between the US and China for supremacy that erupted in 2017 was the first trigger for policymakers to be more concerned with trade, technology, and data – and the geopolitics of it. While the Sino-US rivalry initially presented itself as a tariff war, it is now one of technology and data. 5G telecommunications networks, gathering and use of data, semiconductors and cybersecurity became hotly contested fields.

The next trigger was the COVID-19 pandemic which exacerbated this trend. It exposed digital connections as an opportunity and a life-saver as people were suddenly forced to work, shop and interact online. At the same time, the global pandemic widened the digital divides within and between countries and exposed disruptions and dependencies in the tech supply chain. This triggered a push towards a European agenda of strengthening ‘trusted supply chains’, resilience and autonomy, and a set of strategic initiatives to counteract dependence on strategic goods from China.

The third trigger was Russia’s war of aggression in Ukraine, which started in February 2022. It exposed Europe to yet further challenges of deep and strong digital connections, which were now widely used also for dis- and misinformation, hacking and (threats of) disruption to critical infrastructure.

**PROTECT, SHAPE & REGULATE, PROMOTE**

European governments and businesses have started to act on the challenges of the geopoliticisation of technology and digitalisation in diverse ways. Initiatives of the EU and member states can be broadly categorised into three courses of actions: protect, shape & regulate, and promote (Figure 1). Specific policies and instruments seek to protect European tech leadership and digital rights and principles within EU borders. Moreover, based on the recognition that the choices that foreign governments make also shape Europe’s future, other initiatives are designed to promote European leadership at home and in third countries. Regulation plays an important role in the protection and promotion agendas but shapes the behaviour of foreign governments and companies through a different, more indirect mechanism, namely, the EU’s market power.
Action on all three fronts is necessary if the EU wishes to remain a relevant and resilient player in the digital age. A long-standing challenge yet to be overcome is connecting the dots between the various agendas and ensuring that action is taken in each field. For example, in recent years, much effort has been poured into avoiding dependencies and disruptions in strategic supply chains. But dependencies need to be addressed in other fields too and must be complemented by steps that promote relations with trusted partners to ensure alternatives. The DTS can help unveil this bigger picture and steer action in every field.

Internally, the EU has been working on the regulatory frameworks that seek to empower the Union against the power of Big Tech, such as through the Digital Services Acts (DSA), the Digital Markets Act (DMA) and the Artificial Intelligence (AI) Act. But industrial policy-related initiatives like the EU Chips Act show even more clearly the concern about existing dependencies on external markets. These may cause undesirable disruptions in supply chains that are essential to the twin digital and green transitions. The balance between the protect, shape & regulate, and promote agendas is always on the verge of being challenged by reality. With regard to China, the protect agenda has had prominence and is likely to continue to do so in the future.

A key aspect of the protect agenda is the need to diversify and build alternative supply chains for critical technologies and products where the EU is dependent on China. However, any transition that may be done by the EU is bound to certain limits and set by dependency on external actors, including the private sector. While interdependence continues to be seen as something desirable and good by most Europeans, the aim is to reduce overdependence and vulnerabilities and strengthen credible deterrence.

Knowing where to act requires a clear overview of supply chains on key technologies and finding potential single points of failure in accessing them. Steps towards this end are being made at the EU level and in various member states, including through the Commission’s proposal for a Single Market Emergency Instrument to facilitate the monitoring of supply chains of critical sectors, and a European Critical Raw Materials Act.

Two fronts, in particular, require special attention: externally, finding partners with the ability to develop and provide technologies that are currently imported mostly from China; and internally, working on building the facilities and developing alternative technologies that may bring us closer, in the longer term, to the aspirational open strategic autonomy. While progressively investing in these initiatives, the EU has to assume its reliance on several Chinese goods and maintain a relationship that does not jeopardise the bloc’s needs in the short to medium terms.

Main challenges and opportunities

THE DIGITAL TECHNOLOGY STACK: UNDERSTANDING THE CHALLENGES AND OPPORTUNITIES

In capitalism, policymakers throughout the continent started to invest in the instruments needed to act in confrontations with non-market players and against economic coercion. This includes, for example, foreign direct investment regulation and the International Procurement Instrument, which limits non-EU companies’ access to the open EU public procurement market if their governments do not offer similar access to public tenders to EU companies seeking business. All these tools are new and not country specific. However, they are clearly triggered by China’s assertiveness, asymmetries, lack of reciprocity and lack of a playing field that have been constant in EU-China relations. Other triggers include the increasingly unpredictable behaviour of the United States and Russia, and the US-China rivalry. With Vladimir Putin’s invasion of Ukraine, the EU entered a new phase, marked by even more geo-economic tensions and an increased need to cooperate with partners as problems – including energy and rare earths import dependencies – could not be addressed by the EU and the US alone.

This section employs the concept of the Digital Technology Stack to present the strategic dependencies on technology the EU has in relation to China. More specifically, it uses a version of the Stack that presents digital technology as a layered structure of technological and non-technical components in an attempt to better understand the geopolitical impact of digital technology (see Table 1).

Starting from the bottom of the Stack, the fight for resources and the ability to ensure supply chain security is paramount for the EU. The bloc depends heavily on China in terms of raw materials and rare earths. In fact, 19 out of the 30 raw materials labelled by the EU as critical are mostly provided by China, a country with a key role in mining and processing those materials.

This dependence, in turn, impacts the ability of the EU and its private sector to build the technologies and commercial solutions it needs to implement the green transition (see domain “Environment” in Table 1). The construction of batteries needed for electric vehicles, the solar cells and wind turbines required for the transition, is disrupted by the EU’s limited access to some of the necessary materials on which China has
a monopoly. The impact thereof, however, is not only short-term; second order consequences caused by a slower green transition also have long-term effects.

On the “hard infrastructure” layer, there are several medium-term dependencies. In the semiconductors industry, Taiwan and South Korea dominate the manufacturing market, the US is stronger in designing chips, and the lithography market is controlled by the Netherlands and Japan. However, the growth potential for China is enormous, and some predict a Chinese market share of around 25% by 2030. The EU must ensure that access to all sorts of chips, be it general use or niche-specific, will not be endangered if and when Chinese players realise their potential growth. Furthermore, looming in the back is the precarious relationship between China and Taiwan. The recent statements of President Xi to use force, if necessary, to take the island back under Chinese control raised major red flags. Such a move would have catastrophic consequences for the semiconductors industry supply chains, not only for the EU but for the whole world.

With regard to the telecommunications sector, China already has the biggest contribution in the world in patents for 6G. On 5G, some European countries, including Hungary and Greece, still rely on Huawei’s infrastructure, and this is unlikely to change in the short term. Furthermore, the EU is behind in terms of cloud platforms. The recently approved Digital Markets Act, which aims at increasing competition in the platforms market largely dominated by American firms, may enable the growth of Chinese platforms and companies developing cloud services. Also in this field, the EU must carefully manage its dependency on China.

A less discussed issue in strategic autonomy and (lack of) independence is data, which is sometimes characterised as the oil of the digital era. One of the reasons why China is ahead of everyone else on AI is its access to a virtually limitless pool of data. The lack of privacy safeguards in China allows the country to collect incomparable amounts of data with respect to what Western countries and companies can collect. This, in turn, enables the country to develop much more complex and far-reaching AI and smart algorithms.

Table 1. Unpacking the European Digital Technology Stack: components with a strategic relevance for digital and technological sovereignty.

<table>
<thead>
<tr>
<th>Domain</th>
<th>Layer</th>
<th>Protect</th>
<th>Promote</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digital society and culture</td>
<td>Neo-governance</td>
<td>Decentralisation; open source</td>
<td>Digital principles and rights</td>
</tr>
<tr>
<td></td>
<td>Neo-collectives</td>
<td>Civic organisation</td>
<td>Multi-stakeholderism, digital participation, decision-making and enforcement</td>
</tr>
<tr>
<td></td>
<td>Smart habitat</td>
<td>Data privacy</td>
<td>Digital government (G2C, G2B), ownership of digital ID and finance, (green &amp;) smart cities, smart health</td>
</tr>
<tr>
<td>(Digital) technologies and economy</td>
<td>User interfaces</td>
<td>Data privacy: voice assistant, 3D cameras</td>
<td>Digitally skilled citizens</td>
</tr>
<tr>
<td></td>
<td>Applications</td>
<td>New dual use technologies; dis- and misinformation, election interference</td>
<td>Platform companies (email, social media, fintech, etc)</td>
</tr>
<tr>
<td></td>
<td>Intelligence</td>
<td>Access to ‘smart’ algorithms</td>
<td>High Performance Computing (HPC); AI</td>
</tr>
<tr>
<td></td>
<td>Data</td>
<td>Data privacy</td>
<td>Data ownership &amp; portability</td>
</tr>
<tr>
<td></td>
<td>Soft infrastructure (operational)</td>
<td>Control over essential service providers: cloud software, internet protocols</td>
<td>Interoperability of data &amp; services, technical standards-setting, human capital</td>
</tr>
<tr>
<td></td>
<td>Hard infrastructure (physical)</td>
<td>Integrity and control of critical infrastructure: cyber-attacks, espionage</td>
<td>Telcos (5G, 6G), cloud services, semiconductor industry</td>
</tr>
<tr>
<td></td>
<td>Resources</td>
<td>Supply chains security: energy, raw materials, rare earths</td>
<td>Ownership of critical technologies and products, stable supply of electricity</td>
</tr>
<tr>
<td></td>
<td>Planet</td>
<td>Sustainable habitat</td>
<td>Green technologies/transition</td>
</tr>
</tbody>
</table>

The EU’s privacy legislation (GDPR) limits, for very good reasons, the ability of EU firms to collect data to develop their own algorithms. As an undesirable consequence, surveillance, facial recognition technology, storage and the use of personal data are likely to be areas where the EU simply cannot compete with its Chinese counterpart. Clearly, investments are needed to promote European competitiveness in these fields to reduce dependencies and promote digital autonomy.

Data privacy, as well as data ownership and portability, are linked to the soft infrastructure layer of the DTS since access to the European infrastructure and markets are prerequisites to access to European citizens’ data. Access to data is fundamental to building the databases and algorithms which can potentially disrupt the EU, for example by influencing elections and spreading misinformation and disinformation. The Digital Services Act aims to reduce these risks, but strict control and enforcement must be held by the EU institutions and member states.

These aspects also link to the risks of cyber-security and espionage (see “hard infrastructure” layer). At the G20 meeting held in November 2022, President Xi had a rare confrontation with Canada’s President Trudeau. The argument concerned leaks to the press regarding their discussion about Chinese interference in the country’s elections. Such unwarranted interferences are not to be overlooked. The development of high-performance computing (HPC), as well as quantum computing and communications, can potentially tilt this balance even more in favour of China, should the country win the quantum race.

**Recommendations and conclusions**

This initial inquiry into the EU’s strategic dependencies in relation to China, based on the Digital Technologies Stack framework, suggests that the EU and its industries must work hard on two fronts.

Firstly, where they are too dependent on China, they must find alternatives by joining forces with ‘trusted partners’ in co-designing and co-developing alternative technologies and by diversifying their supply chains. This means acting in the regulate & shape and promote landscape. The lack of European big-tech firms is a symptom of missing coordination on and investments in strategic assets indoors, something that must be addressed without further delays. Policies on the protect-side must be complemented by efforts to shape & regulate internationally.

European leaders are acting on several of the current dependencies on China, but more must be done to ensure digital autonomy and resiliency in all layers of the DTS. The Russian invasion of Ukraine has shown that building open strategic autonomy can be very complex and painful, but the cost of doing nothing will be much higher.

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1 The author gratefully acknowledges the valuable support of Alexandre Ferreira Gomes, Research Fellow at the Clingendael Institute.


3 Further analysis is needed as not all elements are discussed in this paper due to a lack of space.

4 European Commission (2003), EU-China: Commission adopts new strategy for a maturing partnership. IP/03/1231, Brussels.


7 See also Mikael Wigell et al (2022), “Europe facing geo-economics: Assessing Finland’s and the EU’s risks and options in the technological rivalry”; Finnish Government: Prime Minister’s Office.


9 This model is introduced in more detail in: Maaike Okano-Heijmans (2023), *Open Strategic Autonomy: the Digital Dimension*, The Hague: Clingendael Institute. Engineers will be more familiar with the Open Systems Interconnection model (OSI-model), which describes the seven layers that applications use to communicate over a network.


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EU-China political and economic relations in 2023

How have political relations between the EU and China evolved in 2023? How have recent geopolitical developments influenced the trajectory of the EU-China bilateral relationship in 2023? What challenges and opportunities are likely to arise in the industrial relations between the EU and China in 2023, and how are they being addressed? How are the EU and China collaborating on addressing global challenges such as climate change, pandemic response, and sustainable development in 2023? How are the EU and China addressing differences and promoting dialogue in global governance discussions in 2023?
Introduction

Since the easing of Chinese COVID-19 measures, business delegations have started to shuttle between China and Europe, marking a significant turning point for China, Europe, and beyond. As a result, 2023 represents the end of hardship and struggle due to the pandemic and the start of a much-needed reconnection and re-engagement to revive growth and expand businesses.

The current resurgence of Sino-European interactions across nearly all echelons is a promising development that may help bridge the gap in trust and communication that COVID-19 restrictions and lockdown measures have significantly impeded. While the return of these valuable aspects of human interaction is a welcome prospect, the business community remains fully aware of the various challenges and obstacles. These include the ongoing conflict in Ukraine, which has weighed on economic growth and globalisation, the China-US tech war that risks further divergence in global standards and markets, and Europe's mixed perception of a rising China.

Key issues

TRADE: GROWTH VS REDIRECTION

Trade is foundational to bilateral relations, serving as a key indicator of the degree of business proximity between the two sides. In 2022, China was the EU’s second biggest trading partner in goods, with imports and exports totalling €856.3 billion, more than 20% compared with the previous year. China remained the third largest partner for EU exports of goods (9.0%) and the largest partner for EU imports of goods (20.8%).

The structure of Sino-EU trade has been dominated by intermediate and capital goods, reflecting a two-way supply and demand relationship between the upstream and downstream of the global value chain.

It could be concerning that China and the EU appear to be redirecting their trade to other partners. For example, despite a 39% increase in EU imports of goods from China from January 2021 to December 2022, imports from other non-EU partners grew by 72.4%. Meanwhile, EU exports of goods to China grew by only 1.6%, while exports to other non-EU partners grew by 28.8%. China’s total imports of goods from the EU decreased from 13.3% in 2019 to 10.5% in 2022, with ASEAN’s share rising from 13.6% to 15.1%. The current trajectory is likely to persist through 2023, attributable to factors such as the increasing energy cost and Brussels’ efforts to fortify economic, trade and tech alliances with transatlantic partners.

INVESTMENT: A SHIFT FROM M&As TO GREENFIELD INVESTMENT

Bilateral investment between the EU and China has not long kept pace with their impressive trade figures. However, in 2022, there was a remarkable growth of 92.2% in EU investment in China, according to China’s Ministry of Commerce. As for the Chinese foreign direct investment (FDI) in the EU, massive single greenfield investment, such as leading market player Contemporary Amperex Technology Co., Limited (CATL)’s announcement of €7.34 billion investment to build a 100 GWh battery plant in Hungary, could have a significant impact on this year’s reading as well. The manufacturing industry accounted for half of the two-way investment between China and the EU, indicating a solid foundation for economic and trade cooperation in the real economy.
In the realm of Chinese investment within the EU, a discernible shift exists away from the pursuit of mergers and acquisitions (M&As) in favour of a focus on greenfield investment. This development can be attributed to the rising number of regulatory barriers faced by M&A endeavours, including the EU’s FDI screening mechanism, which became fully operational as of 11 October 2020. The Foreign Subsidies Regulation (FSR) represents another EU toolset to further discourage Chinese investors from engaging in M&As, which is slated to be officially implemented in July 2023.

Chinese enterprises, such as Great Wall Motor, have established manufacturing bases in Europe to optimise their global supply chain and better serve local consumers. Others have chosen to undertake greenfield investment aimed at achieving compliance with European industrial policies and supervisory regulations.

The China-EU Comprehensive Agreement on Investment (CAI) has the potential to serve as a groundbreaking treaty aimed at expanding market access for investors from both the Chinese and EU perspectives. However, in the near future, the likelihood of its ratification by the EU appears to be low.

**DIVERSIFYING: ON THE HIGHWAY TO DECOUPLING?**

The EU has claimed that the bloc is not seeking to decouple from China but to diversify its supply chains and reduce its dependence on the country. Accordingly, it is trying to re-shore its supply chains and raw material production and seek export bans on critical technologies such as chip printers. While these efforts aim to reduce the risks associated with over-reliance on China and promote greater resilience and competitiveness, they also carry the potential for decoupling the two economies.

Decoupling of the EU and China’s economies would have significant implications for both parties. For the EU, the decoupling would lead to disruptions in its supply chains and cause adverse effects on its economic growth, particularly in sectors where China plays a significant role, such as solar panels, batteries, and electronics. It could also affect the EU’s efforts to promote global governance and cooperation on climate change, as China is a major player in these areas. On the other hand, China’s economy could also be affected by decoupling, particularly in terms of losing access to the EU’s high-end technologies and markets. This may lead China to seek alternative sources of supplies and markets.

**Main challenges and opportunities**

**CHINA-US-EU TRIANGLE**

The notion of a geopolitical shift in the EU has been prevalent for some time, but the outbreak of the conflict in Ukraine accelerated it. In response to the conflict, the EU began to reduce its high dependence on Russian energy and instead focused on developing closer economic and trade relations with the United States. However, the transatlantic alliance appears to have distanced itself from non-Western countries.

Under the Biden administration, closer transatlantic ties are forging a more united front in the face of China’s rising power and influence. The EU has started to decouple its technology from China in the same way that the US has. The Netherlands, for example, has opted to tighten export restrictions on advanced lithography machines, while Germany intends to ban the use of Huawei and ZTE 5G equipment and components.

From a strategic standpoint, complete alignment with its partners would place the EU at a disadvantage in its autonomy and future development. The associated geopolitical risks could also deter Chinese companies and prompt them to explore other less susceptible markets to power games.

**BUSINESS POLITICISATION**

The EU, founded upon principles of economic integration, has achieved considerable success in establishing the world’s major free-trade bloc - the Single Market. Moreover, throughout its history, the EU has been a staunch advocate for multilateralism. Nevertheless, considering the bloc’s redefinition of China as a ‘partner, competitor, and systemic rival’ in 2019, the influence of value-based politics on the EU’s trade and economic agenda has become increasingly pronounced.

The bloc has launched a series of unilateral economic and trade tools, including the 5G security toolbox, FDI screening, FSR, anti-coercion instrument, dual-use export controls, international procurement instruments, and supply chain due diligence, to name a few, making the trend of inward-looking and protectionism more obvious. According to a survey conducted by the China Chamber of Commerce to the EU (CCCEU) and Roland Berger in 2022 involving 150 Chinese companies and organisations operating within the EU, 38% of respondents indicated that their business operations had suffered adverse effects due to the prevailing political climate. This negative trend in ratings can be attributed to the shared struggles encountered by the surveyed Chinese enterprises, namely, the EU’s general policies, unilateral economic and trade instruments, and generally
unfavourable public opinion toward Chinese enterprises, all of which pose significant obstacles to integration into the local market. Additionally, the dynamic nature and lack of consistency among the economic and trade policies of the EU and its member states further exacerbate the difficulties faced by Chinese enterprises.

Before the summer break, the China-EU summit in Beijing will provide a unique opportunity for both sides to iron out differences and improve mutual understanding, which is expected to boost business confidence. Ambassador Fu Cong, the head of the Chinese Mission to the EU, told a luncheon on 13 March 2023 that summit preparations were “at a very early stage” with Chinese and EU officials working on subjects for leaders to discuss.

The upcoming China-EU summit will be important as it will be the first time the current EU and China’s new government have met in person since the two sessions. During the 23rd China-EU summit on 1 April 2022, Chinese President Xi Jinping called on the EU to create a fair, transparent, and non-discriminatory environment for Chinese companies to invest and develop in the EU. In anticipation of the summit, the business community is eager for further discussion on their concerns, and there is potential for the summit to explore more opportunities for engagement with the business sector.

**TWIN GREEN AND DIGITAL TRANSITIONS**

China and the EU have committed to achieving net-zero emissions by 2050. While collaboration on renewable energy, green technologies, and sustainable infrastructure could also lead to new business opportunities and partnerships. In 2022, 85% of Chinese enterprises believed the EU’s green economy strategy would bring more opportunities than challenges.

The EU possesses extensive experience and has developed industries in green development areas such as environmental protection, particularly in low-carbon technology. The EU ranks first globally in researching and developing low-carbon technologies like smart grids, hydrogen energy networks, and carbon capture and storage. China is emerging as a green powerhouse with nearly a third of the world’s renewable energy patents and occupies an advantageous position in producing and processing essential minerals. The country’s solar panels, batteries, and electronic vehicles are also becoming the new engine for the growth of exports.

China and the EU exhibit their own strengths and weaknesses in green economic pursuits. However, both sides can achieve sustainable development by leveraging their complementary advantages in technological innovation, natural resources, and human capital to accelerate green transformation through comprehensive cooperation across different fields. In 2023, Chinese and European companies are expected to explore further the potential for collaboration in the green economy.

The digital economy is a crucial area for global competition in the context of worldwide technology and the industrial revolution. Businesses from the two sides can step up cooperation in many segments of the digital industry, such as data sharing, the Internet of Things, artificial intelligence (AI), smart cities, and the digitalisation of conventional industries. In 2022, 70% of the Chinese enterprises surveyed believed that the partnership between China and the EU in the digital economy would become closer in the long-term.

**Recommendations and conclusions**

To deepen bilateral consensus, foster cooperation, and advance development, the CCCEU proposed nearly a hundred practical suggestions for China-EU development and cooperation in 2022, many of which are still relevant:

- **Deepening mutual trust and sustaining the China-EU comprehensive strategic partnership for mutual benefit and win-win results**

  At a time when geopolitical conflicts are worsening and relations between major countries are going through changes, China and the EU have many common goals, such as promoting world peace, achieving further development, and advancing cooperation, all of which form the foundation for the two sides to show mutual respect, seek common ground while shelving differences, and continue to grow their comprehensive strategic partnership for mutual benefit and win-win results.

- **Eliminating the impact of sanctions and promoting pragmatic cooperation**

  China and the EU should strive to eliminate the effects of mutual sanctions imposed in 2021 through dialogue and clear the way for pragmatic cooperation, especially in key sectors such as economy and trade, technology, energy, pandemic response, climate change, and coordination in multilateral institutions.

- **Formulating the China-EU 2025 Strategic Agenda for Cooperation at an early date**

  The business community expects the China-EU 2025 Strategic Agenda to be formulated early to promote the comprehensive strategic partnership and advance bilateral cooperation and mutual progress.
 continua the growth potential of China-EU bilateral trade

The two sides should commit to creating a better policy environment for each other, optimising the trade structure and further unleashing trade flows.

Adapt to changes in each other’s industrial structures and exploring new areas of cooperation

In sectors such as trade in services, green industry, digital industry and other emerging market segments, China and the EU can seek to cooperate more. The two sides can make more progress on investment in third-party markets and implementing projects concerning the aligning the Belt and Road Initiative and the Euro-Asian connectivity strategy.

Safeguard the stability of global value chains and supply chains

The two sides could upgrade China-EU freight transport facilities for higher capacity, enhance cooperation in maritime transport, aviation logistics, and promote the development of the China-Europe Land-Sea Express Route.

Safeguard a fair and open business environment based on clear rules and eliminating the negative impact of unilateral instruments

Chinese enterprises expect the EU to refrain from generalising the concept of strategic security and reduce the time and compliance costs for Chinese investors to promote the investment of Chinese enterprises in the EU.

Promoting flagship joint R&D programmes and boosting R&D cooperation in green and emerging technologies

China and the EU should strengthen R&D cooperation in emerging energy sectors such as hydrogen and e-methane, set up joint flagship R&D programmes, and encourage Chinese and EU enterprises to jointly roll out pilot projects and integrate their value chains concerning emerging technologies.

Encouraging Chinese renewable energy enterprises to participate in the construction of the EU’s charging facilities

The two sides should strengthen dialogue and cooperation in setting up standards and launching pilot projects for charging and battery swapping infrastructure, and work together to establish a harmonised global standard system in the next-generation high-power charging and battery swapping area.

Removing market barriers imposed in the name of cybersecurity

The business community calls on the EU to maintain a fair and non-discriminatory market environment, be open to cooperation, eliminate market barriers in cybersecurity, and prevent the EU and its member states from discriminating and imposing bans against Chinese suppliers in their 5G legislation.
The EU-China business relationship: A roadmap for fulfilling its potential

Introduction

In 2022, European companies’ confidence in the Chinese market sank to the lowest level on record. As much of the rest of the world returned to pre-pandemic levels of normality, China’s business environment deteriorated rapidly following its adoption of more stringent COVID-19 containment measures and Russia’s invasion of Ukraine.¹

China abruptly ended its zero-COVID strategy in late 2022, providing new hope that 2023 will offer a year of more certainty. Its leadership also signalled its readiness to open up further and recommit to multilateralism and international cooperation in the name of “world economic stability and development, and economic re-globalization”.² However, trust will not be restored overnight, and it remains to be seen whether such rhetoric will be matched by action.

The lack of a level playing field and reciprocal market access in China heightened geopolitical tensions, and supply chain complications are pushing European businesses to re-evaluate the role of China in their global operations.³ European businesses remain committed to the Chinese market – its size, profitability, and dynamism mean they need to have a footprint in the country to be globally competitive. However, as governments respond to the uncertain environment in China by reducing engagement, and businesses increasingly consider decoupling their China operations from their global operations and/or shifting investments to other markets,⁴ the chances of miscommunication and misunderstanding have increased. This issue risks being further aggravated by rising negative public opinion in many countries towards China, which in turn pushes foreign governments—including those in Europe—to take harsher stances towards the country.⁵

Fortunately, there are steps the EU and China can take to begin to restore trust and rebuild their relationship. These include restoring people-to-people exchanges, deepening cooperation in areas of shared interest, and continuing to resolve longstanding market access and regulatory issues.
Key issues

CHINA'S 'ONE ECONOMY, TWO SYSTEMS’ MODEL

After embarking on an ambitious programme of reform and opening up, which facilitated its accession to the World Trade Organization (WTO), China’s efforts in this area have stalled over the past decade. While some segments of China’s economy have continued to open and become increasingly well-regulated, others remain dominated by state-owned enterprises (SOEs), many of which receive preferential access to financing, licences and public procurement, while maintaining a disproportionate influence on policymaking. This prevents a significant number of European businesses from competing on an equal footing and has even resulted in several being pushed out of the market altogether, while heightening the uncertainty faced by those that remain.

As part of the attempt to stimulate economic recovery after the sudden abandonment of stringent pandemic-control measures, Chinese officials are once again seeking to reassure the private sector that further market-orientated reforms will be implemented. However, so far, limited tangible action has been taken.

THE POLITICISATION OF BUSINESS

The EU-China relationship has yielded an astonishing number of issues that have raised concerns and heightened political risks for businesses. European public opinion on China has also soured, and vice versa, a situation that has been exacerbated by the dearth of people-to-people exchanges over the past three years due to COVID-19-related travel restrictions. These factors have resulted in a decreased appetite for EU-China cooperation.

At the consumer level, businesses have increasingly been caught between a rock and a hard place, facing conflicting demands from Western and Chinese stakeholders. For example, companies that have come under pressure in the West to cease operating in Xinjiang are perceived as acting against China’s interests, raising the risk of boycotts from Chinese consumers.

At the political level, businesses are coming under increased scrutiny from Western governments to demonstrate transparency in their China operations, including as a result of new and forthcoming legislation. In particular, businesses operating in sectors considered contentious in China face heightened political risks, a trend most evident in the technology and digital space, particularly with US-China competition continuing to intensify in this area. The instance of economic coercion used against Lithuania has further added to political tensions.

TO DIVERSIFY OR NOT?

The issue of supply chain security has now come to the fore in the EU where, at the time of writing, there is an ongoing debate over whether, or to what extent, Europe should diversify away from China. It raises the question of how to best engage with China strategically while simultaneously removing the country’s ability to use economic coercion against Europe.

Key to this will be eliminating areas in which the EU has critical dependencies on China while not adopting a blanket policy of disengagement, which would lead to economic hardship for European consumers and risk undermining the global competitiveness of European businesses. In this respect, it is important to note that, while China is the EU’s largest trading partner in value terms, the majority of goods it exports to the bloc are relatively substitutable. The EU is only critically dependent on a limited number of imports from China, most notably rare earth metals and some pharmaceutical products.

Main challenges and opportunities

RESTORING TRUST

Until late 2022, China was largely closed off from the rest of the world. European policymakers, business executives, journalists, students and tourists were deprived of a first-hand China experience. An information vacuum developed, which fuelled growing suspicion on both sides, resulting in reduced trust, less cooperation and an increased chance of misunderstanding.

Now that China’s borders are reopening, people-to-people exchanges can resume as an essential first step to rebuilding trust. Both sides will need to create the conditions to ensure that any dialogues that take place at the institutional level will be constructive. Additionally, all travel restrictions need to be removed. While EU member states agreed in February 2023 to phase out COVID-related restrictions imposed on travellers arriving from China, at the time of writing, restrictions are still being placed on Europeans travelling to China.
COOPERATING IN THE FACE OF RISING TENSIONS

EU-China tensions, such as in areas of technological competition or over allegations of forced labour and detention of ethnic minorities in Xinjiang, have grown in recent years. Although these issues must be tackled, continued EU-China engagement is vital if both sides are to overcome the numerous shared challenges they both face. Areas of mutual interest, such as sustainable development, advancing WTO reform and promoting international standardisation, provide opportunities for deepening EU-China engagement.

One area especially ripe for EU-China cooperation is tackling climate change, an issue that cannot be solved without China’s involvement. Not only do political interests overlap—with China setting itself the ambitious target of achieving carbon neutrality by 2060 and the EU by 2050—but there is also much to be gained from industrial cooperation. European companies are world leaders in a number of decarbonisation-related fields and have extensive experience working on related projects in their home countries, making them well-placed to boost China’s efforts. For its part, the size and dynamism of China’s market offer European companies the potential to scale and accelerate the development of their green technologies.

REMAINING PRESENT IN CHINA WHILE MITIGATING RISKS

Most European businesses remain committed to China: it keeps them profitable, innovative and globally competitive, and the market still holds enormous untapped potential. However, to remain, they must find ways to mitigate a growing number of risks.

China’s push for domestically-manufactured products is creating an increasingly unlevel playing field for European companies, while requirements to localise IT infrastructure and data storage facilities are pushing more and more companies to further localise their operations – a trend that became more pronounced as both China’s COVID-related lockdowns and rising geopolitical tensions exposed the fragility of global supply chains. At the same time, Russia’s invasion of Ukraine has led many companies to reconsider their China strategies, set up contingency plans, and undertake scenario planning to understand the impact of a potential blockade, or even invasion, of Taiwan on their global operations.

MAINTAINING OPERATIONS WHILE MEETING GLOBALLY-BINDING LEGISLATION

European companies must minimise the risks associated with doing business in China in order to both comply with new and emerging legislation and satisfy corporate pledges. They employ a variety of strategies, including diversifying supply chains, localising production, and even re-examining to what extent they can continue to operate as they come under increasing pressure to demonstrate transparency in their China operations.

For example, businesses exporting from China to the US are now bound by the Uyghur Forced Labor Prevention Act to prove they are not involved in forced labour practices. Similarly, the EU’s planned Corporate Sustainability Reporting Directive (CSRD) will introduce strict reporting requirements, obliging large public-interest companies to report on environmental, social and governance (ESG) and human rights issues. Under the CSRD, companies’ sustainability reports will have to be certified by independent, third-party auditors, something that is currently not possible in China. Unless the conditions are created that allow them to prove their compliance, European companies may need to close their operations in Xinjiang.

Recommendations and conclusions

With China reopening its borders, there is now an opportunity to reset EU-China relations. To do this successfully, it is important that European stakeholders do not adopt a blanket approach to China while ensuring strategic concerns are not overlooked. The EU must continue to insist on transparency and corporate sustainability, confront instances of economic coercion and work on resolving long-standing market access issues.

However, this should not come at the expense of engagement at the political level.

The EU and China should take advantage of the ability to engage in people-to-people exchanges, identify and restart the dialogues that have historically been the most productive, and work towards delivering concrete results.
RECOMMENDATIONS FOR CHINA

- Refocus on reform and opening up to address market access and regulatory issues and to increase the predictability, reliability and efficiency of the business environment.

- Remain committed to globalisation and contribute to the strengthening of multilateral institutions.

- Refrain from erratic policy shifts and seek consultation with business, allowing reasonable transition times before implementing any changes to policies or regulations.

- Allow flexibility and accept feedback from key stakeholders from government, think tanks and industry so that new policies can be developed, and existing ones adapted, to tackle emerging challenges in a way that does not sacrifice other key priorities such as sustainable economic growth.

- Continue with reforms that bring SOEs more in line with market forces through the adoption of modern governance structures to make them more efficient, and eventually implement ‘competitive neutrality’.

- Continue to increase international flights to China and drop any travel restrictions.

- Provide the conditions that allow companies to conduct independent, third-party audits of their operations so that they can be certified as fully compliant with global legislation.

- Continue to work with the EU and other key interlocutors to de-escalate tensions over Taiwan.

- Engage in dialogue with other governments and key stakeholders to depoliticise the business environment and refrain from punishing companies for the actions of their home governments.

- Increase China’s integration with the global economy and steer away from excessive ‘self-sufficiency’.

- Develop nuanced strategies for strengthening supply chains that do not err towards trade protectionism.

- Develop sound institutions that can provide a truly level playing field between foreign and Chinese investors and make administrative processes transparent, consistent and predictable.

- Deepen EU-China cooperation in areas where interests overlap, such as in relation to combating climate change, international standards-setting, sustainable development and WTO reform.

- Ensure that European businesses can fully contribute their expertise and technology to help China achieve its carbon neutrality goals.

RECOMMENDATIONS FOR THE EUROPEAN UNION

- Continue to proactively engage with China and reject calls for disengagement.

- Remain deeply integrated with the global economy and steer away from excessive ‘self-sufficiency’.

- Enhance the overall coordination between member states and EU institutional stakeholders to foster a united European approach towards China.

- Avoid provoking China unnecessarily while defending European core interests.

- Ensure that responses are measured and proportionate when EU-China disagreements arise.

- Deepen EU-China cooperation in areas where interests overlap, such as in relation to combating climate change, international standards-setting, sustainable development and WTO reform.

- Re-calibrate the EU’s China strategy in such a way that reflects both existing and emerging priorities and challenges and strikes the right balance between collaboration and competition.

- Continue to engage with chambers of commerce, China-focussed think tanks, industry organisations and standard-setting bodies when formulating China policy to ensure that it reflects on-the-ground realities.

- Strengthen the competitive capabilities of European players by developing bottom-up industrial policies that promote market competition and innovation in strategic industries, without prescribing technological pathways.

2 Ministry of Commerce of the People's Republic of China (2023), “Vice premier reaffirms China’s commitment to growth, int’l cooperation”.

3 For an expansion of this argument, see: European Chamber of Commerce in China (2022), “European Business in China Position Paper 2022/2023”.


6 European Chamber of Commerce in China (2022), “European Chamber Stance on the Liberalisation of Ownership Restrictions in the Automotive Sector”.

7 "Xi calls for furthering SOE reform", China Daily, 18 October 2017.

8 European Chamber of Commerce in China (2022c), op.cit, pp.26-27.

9 Ministry of Commerce of the People's Republic of China (2023), op.cit.


16 “Europe’s energy war in data: How have EU imports changed since Russia’s invasion of Ukraine?”, Euronews, 24 February 2023.


18 European Chamber of Commerce in China (2022b), op.cit.


20 These measures were introduced in January 2023, following concerns that China’s sudden abandonment of outbound travel restrictions amid large-scale outbreaks across the country could lead to the appearance of new COVID-variants.

21 Embassy of China to Thailand (2023), “Notice on requirements for the COVID-19 epidemic prevention and control of passengers traveling to China”.

22 European Chamber of Commerce in China (2022) “Carbon Neutrality: The Role of European Business in China’s Race to 2060”.

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China’s solution to a new global economic governance

Introduction

The ‘hyper-globalisation’ ended when geopolitical conflicts, a sluggish global economy and climate change brewed discontent within the world order. To address more common issues worldwide, it is indispensable to enhance the economic connection between countries and regions smartly and reshape global economic governance. As the practitioner and beneficiary of globalisation for over 40 years, China will continue to contribute to global economic governance and embrace the new wave of globalisation.

Key issues

A STRUCTURAL CHANGE

Globalisation has come to a new crossroads after 40 years of unprecedented economic prosperity in the world. ‘Global Governance 1.0’, the international system based on the UN and Bretton Woods institutions, has been confronted with various challenges ranging from changing geopolitics, rapid technical advancement, and global societal and economic transformations to the accelerating pace of climate change. As Nobel Economics Laureate Joseph Stiglitz famously said in Globalisation and its Discontents, “globalisation is not working for much of the world’s poor. It is not working for the stability of the world’s economy.”

Why is there ‘discontent’ with globalisation?
The simplest answer is: the world is undergoing structural change.

A MULTIPOLAR WORLD

The world is now more multipolar as it has witnessed the rise of developing countries in the past four decades. Nowhere is the shift to multipolarity more evident than in the rise of Asia, given that its economy is now bigger than the rest of the world combined. The simple reality is that no single power can dictate global norms and rules by itself. The existing US-led system, designed for a world where power is concentrated in the hands of one superpower, is increasingly becoming untenable.

MORE INTERDEPENDENCE

However, the multipolar world is also more interdependent. The fates of different countries are more interwoven than at any point in human history. Rising interdependence stems from two related sources. The first is cross-border flows of people, goods, capital, ideas, and data that tie the interests of different countries together through global supply chains, cultural flows, and global finance. The second is the rise of transnational challenges - usually known as non-traditional security threats, such as the COVID-19 pandemic - that heavily disrupt the global supply chain. Our current system of global governance was designed in an age when the most salient security threats that countries faced were those emanating from other states. Deepening cross-border linkages and shared global threats mean that global governance should facilitate collective responses to various challenges.
DIGITAL ECONOMY

Nowhere is the growing interconnectedness more visible than in the rise of transnational data flows and the global digital economy. The digital economy’s volume from 47 major economies claimed 45% of the world GDP in 2021, marking a 15.6% year-on-year increase, according to the report from China’s Academy for Information and Communications Technology (CAICT). The pandemic accelerated this digitalisation, and even though its full implications for global governance are not yet clear, they are surely profound and manifold.

Unfortunately, the booming global digital economy encounters a threat from geo-economics - the use of economic tools to advance geopolitical objectives. Economic relations are increasingly a source of friction undermining international cooperation and global governance. The COVID-19 pandemic further increased calls to ‘re-shore’ production, with some governments intervening to draw supply chains home. As Pascal Lamy, former Director-General at the World Trade Organization (WTO), has pointed out, in the aftermath of the pandemic, a certain degree of ‘protectionism’ - legitimate safeguarding of citizens’ needs - was to be expected.

The current world order was already shifting to an uncertain period when rising geopolitical tensions between the world’s largest economies daunted the international community. The US-China relations are seemingly sliding into the self-fulfilling prophecy of the “Thucydides Trap”, as Harvard Professor Graham Allison described it. Russia’s “special military operation”, which began in 2022, declared the collapse of the Yalta System founded on the relics of WWII. A dichotomy of democracy vs autocracy, a ghost of Cold War mentality, is becoming increasingly dominant within some great powers’ narratives. It is hard not to link this moment to the half-century-long period when the two largest superpowers deterred each other with their nuclear arsenals. The common challenge posed to the world is neither the inaction to disasters or conflict nor the shedding of shared responsibility but the normalising of mutual hostility.

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A MORE INCLUSIVE, INTEGRATED AND FLEXIBLE GOVERNANCE

To adapt to these realities, a new global economic governance will need to embody three principles.

1. It needs to be more inclusive. It should better represent the voices and interests of emerging economies and mobilise a new set of actors to work on global problems, including developing countries and the unvoiced part of advanced economies.

2. Global economic governance needs to be more integrated. Complex, cross-cutting challenges need to be addressed in an integrated manner, accounting for links between different sectors and issues based on strong connections between global and regional organisations, international financial institutions, and other global alliances and institutions.

3. Lastly, our post-pandemic world calls for more flexible global institutions. Rather than sticking to large, unwieldy member-driven formats for all purposes, global mechanisms should be tailored to the job at hand. For some purposes, such as kick-starting the process of reforming key global institutions, a smaller group of powers may be preferable. For other tasks, it may be more suitable to forge a broad and inclusive group of nations and other stakeholders.

RISING REGIONALISM

As global trade rules fray, a patchwork of regional deals has emerged as vehicles for deeper liberalisation. Pioneered by the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), launched in 2018, the new free trade agreement between the US, Mexico and Canada (UMSCA) which came into force in 2020, followed by the African Continental Free Trade Area (AfCFTA), which started trading in 2021. The latest achievement is the activation of the Regional Comprehensive Economic Partnership (RCEP) - the free trade agreement including 10 ASEAN member countries plus China, Japan, South Korea, Australia and New Zealand – in 2022. Some of these new regional multilateral initiatives address existing gaps in global governance by bridging consensus and bolstering cooperation, thus providing feasible alternatives for the global system.

To reform the less functional ‘Global Governance 1.0’, we need to accommodate these dynamic regional solutions and increase their coordination so that they work together harmoniously. More importantly, we need to exploit the latest technical developments and take advantage of these interdependencies for the benefit of our well-being.

Main challenges and opportunities

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THE UNIQUENESS OF CHINA

As the world’s second-largest economy and one of the most populated countries, China has a unique role in leveraging global governance. Its persistent development in the past half-century has not only enriched the diversity of world history but also rewritten the world economic map. Between 2013 and 2021, China contributed up to 38.6% on average to world economic growth, more than the G7 countries combined, according to the Foreign Ministry spokesperson. Furthermore, as it was increasingly aware of the importance of sustainable
The outbreak of COVID-19 and Russia’s war in Ukraine in 2022 severely undermined the joint effort of the international community to restructure globalisation. China, on the contrary, demonstrated its economic resilience in the pandemic while managing to reconnect with the world at the end of 2022. It quickly resumed its face-to-face diplomacy with the international community, and its leadership frequently visited the major stakeholders in global geopolitics. Meeting with US President Joe Biden at the G20 Bali Summit, President Xi Jinping reassured the world of his intention to reset the framework for Sino-US relations. As the first anniversary of the war in Ukraine was approaching, China published the Global Security Initiative Concept Paper and China’s position paper on the Political Settlement of the Ukraine Crisis. In the latter, China reiterates its opposition to armed attacks against nuclear power plants and its warning that “nuclear weapons must not be used and nuclear wars must not be fought” has been applauded by the international community. All the above efforts might be squandered if other countries are unwilling to respond. China cannot work alone, and multilateralism is key for international cooperation. 2023 will witness flourishing international dialogues to revive the collaborations on bilateral and multilateral mechanisms. We are expecting that, in the coming summits of the BRICS, the G20, the G7, and the Asia-Pacific Economic Cooperation (APEC), shuttle diplomacy will bring fruitful achievements to help restore a fair and just world order.

Recommendations and conclusions

- **Promote WTO reform**

As bilateral or multilateral investments and trade agreements are on the rise, the WTO continues to be a core promoter of investment and trade facilitation, reducing tariff and non-tariff barriers and eliminating differential treatment in international trade. It still plays an irreplaceable role in promoting trade liberalisation, optimising global resource allocation, and expanding commodity production and flow. A reform of the WTO would boost the confidence of the international community in the multilateral trading system and multilateralism. In the future, we hope that all parties will promote WTO reforms and that the WTO will once again fully play its role in maintaining and mediating international multilateral trade.

- **Resurrect the China-EU Comprehensive Agreement on Investment**

China and the EU share extensive common interests and a solid foundation for cooperation. Still, over the past two years, China-EU relations have quickly deteriorated, and the two sides have reached an impasse on the Comprehensive Agreement on Investment (CAI), which has been hailed as China’s second round of reform and opening-up. The Agreement contains many conditions and benefits that even the US has not previously enjoyed and establishes a more open and higher-level standard for European companies. To overcome this impasse, China’s National People’s Congress ratified the International Labour Organization’s 1930 Forced Labour Convention and the 1957 Abolition of Forced Labour Convention in April 2022, making efforts to revive the China-EU Bilateral Investment Treaty (BIT). Resuming communications may mean that the two sides can negotiate and lift sanctions, allowing the CAI to go into effect as soon as possible and bringing an economic boom to Chinese and European enterprises.

- **Multilateralise the Belt and Road Initiative**

The Belt and Road Initiative (BRI) must be reconfigured as a multilateral endeavour for global governance and development. Since it was launched in 2013, the BRI has become a vector of globalisation, growth, and investment in many regions. Belt and Road projects have created nearly 300,000 jobs. The World Bank estimates that host countries have reduced shipping times by up to 3.2% and trade costs by up to 2.8%. In addition, the initiative has helped build the so-called ‘soft’ infrastructure, such as education, healthcare, and other services in many African countries. When the time is right, China can propose cooperation in infrastructure between the BRI, the EU-led programme ‘Global Gateway’, and the US-led ‘Build Back Better World’ (B3W).

- **Upgrade the Asian Infrastructure Investment Bank to the Global Infrastructure Bank**

Over the last six years, the Asian Infrastructure Investment Bank (AIIB) has established itself as an effective multilateral development bank (MDB) and successfully integrated into international financial architecture. Having attracted advanced economies as voting members and adopted the high standards of other MDBs, it has gained recognition from multilateral organisations, like the UN, and AAA ratings from leading rating agencies. With a fresh capital injection and expanded membership, the bank would be well
placed to expand its remit and become the Global Infrastructure Investment Bank (GIIB). This would involve inviting new members to play a major role, including countries in other regions, such as Africa and Latin America. In addition, the GIIB could form a special body for multilateral actors, including MDBs and regional organisations, to enhance coordination between existing infrastructure initiatives worldwide.

**China should move towards joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership**

While working to revive the global free trade agenda, China should also be an active participant in the free trade agreements (FTAs) developing at the regional level. China should move toward joining the CPTPP, a higher standard FTA geared to advanced economies. Joining the 11-member CPTPP would push back against decoupling and protectionism. It would also provide an external impetus for the next phase of reform and opening. CPTPP’s principles are well aligned with China’s goals to improve Intellectual Property Rights (IPR) protection and reform state-owned enterprises (SOEs). In the long term, an enlarged CPTPP could provide a blueprint for reforming the WTO and getting the global free-trade agenda back on track. Chinese membership could help reduce friction and the rise of geoeconomics by aligning China closer with progressive global trade norms.

**Establish global digital economy normative agreements and regulations**

The digital economy is a key engine and an important trend in world economic development. A new framework must be established that can support the safe and healthy growth of the global digital economy. On 12 June 2020, Singapore, Chile, and New Zealand signed the Digital Economy Partnership Agreement (DEPA); perhaps the G20 could also further explore the regulations related to digital trade based on the Osaka Declaration on Digital Economy. The establishment of an International Data Alliance (D20) composed of the world’s 20 largest digital economy companies should also be considered to enhance the G20’s ability to better promote global governance in the digital economy.

**Cooperate in green development**

Green issues may offer a more promising field to forge consensus and meaningful reform. In particular, China could work with other partners to promote the creation of a dedicated UN institution focused on climate change as a unique crisis that affects many areas of global cooperation.

Green development will reshape the way we handle products across their entire life cycle, from design and production to use and end-of-life disposal or recycling. Transforming this whole process requires new business models and forms of collaboration across the industry. Pressure to reduce carbon emissions and the environmental footprint of products will drive a ‘greening’ of supply chains and encourage multinational enterprises to adopt green technologies and business models, opening new prospects for cooperation.

Global governance needs to be more inclusive and geared to twenty-first-century problems like climate change and addressing inequality by boosting free trade, overcoming the global infrastructure gap, and closing the digital divide. The year the book *Globalisation and Its Discontents* was published was probably the heyday for China’s longstanding economic growth, owing largely to dividends of the country’s reform and opening up, and its entry into the WTO, which stimulated domestic consumers’ confidence and expanded exports for the next two decades. China has been a beneficiary of globalisation, and its economic growth has shifted from take-off to maturity and the age of high mass consumption. However, after a thorough retrospect, one will find that China, too, faces challenges, with pressures at home and questions about how other countries will respond to its rise. However, it is in the interest of both China and other countries that the world’s most populous country plays a leading role in shaping the next iteration of global governance.
Global economic governance after the watershed: Implications for EU-China relations

22 March 2023

Introduction

A WATERSHED MOMENT IN EUROPEAN HISTORY

Russia’s war of aggression against Ukraine, in conjunction with the COVID-19 global pandemic, has shaken the foundations governing the international economic and political order and raised questions about the future of globalisation. While the COVID-19 global pandemic has inflicted significant health, social, economic and political costs worldwide, Russia’s ongoing war against Ukraine threatens global security, dampens prospects for post-pandemic recovery, and demonstrates significant instability to global economic governance. The geopolitical environment has become more contested, challenging global institutions and the framework in which globalisation has occurred in the last decades.

The invasion of Ukraine launched by President Putin represents a watershed moment in European history.\(^1\) Russia is threatening European stability and security, violating the territorial integrity of an independent country. In its foreign and domestic policy, the EU has always emphasised the importance of multilateral cooperation and respect for international law. Economic and political interdependence has been seen as a way of reducing the possibility of war while promoting prosperity, peace and security, and the respect of fundamental rights and freedom. Regrettably, in external relations, in the case of actors like Russia that disregard international law, this idea has been proven wrong.

The EU has been able to react swiftly in conjunction with international partners, in particular the US. In a matter of days, it welcomed Ukrainian refugees and provided military and financial support to Ukraine. In addition, it has imposed ten sanction packages against Russia and adapted its security and energy policies at the national and European level. Nevertheless, Russia’s invasion of Ukraine is not only a regional European war. It marks a defining moment in reshaping the geopolitical and economic order with repercussions for the world.
Key issues

**ECONOMIC OUTLOOK**

The global economic environment remains challenging for the coming period. The rate hikes around the world to tame inflation, tightening financial conditions, and China’s slowdown have weighed on global growth in 2022. Investment and consumption rose in the third quarter of 2022, but economic activity (in China especially) slowed down in the fourth quarter. However, recent events could lead to some improvements for this year thanks to China’s full reopening and the easing of supply bottlenecks. Further crunch points might emerge throughout the year. For instance, some emerging markets face debt distress (despite the recent US dollar depreciation and a general easing of global financing conditions). In addition, the collapse of the Silicon Valley Bank on 10 March 2023 prompted concerns worldwide of widespread contagion. Stock markets fell in recent days, but for the time being, it remains unclear whether a generalised banking or financial crisis will happen or not.

The knock-on effects of Russian aggression on the EU economy are considerable, given its historical reliance on Russian gas. The invasion has triggered a cost-of-living crisis in Europe, with many households struggling to pay for food, heating and transport. In the Euro Area, inflation has been at a record high, fuelled by high energy and commodities prices. Energy prices have been declining since the peak of August 2022, bringing down headline inflation which was (on a yearly basis) 8.6% in February 2023, down from 8.5 in January. The European Central Bank (ECB) is raising interest rates as core inflation increases, potentially posing financial stability concerns for overindebted countries. The outlook looks less gloomy than a few months ago, but relatively low growth and inflation will remain.

**GOODBYE FREE TRADE (??)**

At least in part, the global economic system and the associated international rules, as we know them, are a US invention put in place with the experience of World War II in mind. This has shaped the rise of global economic interdependence, which in turn, has generated economic benefits for many across the globe. The architects of the system hoped that this could help to spread prosperity, peace and democracy across the world within a rules-based multilateral system.

However, this belief has been increasingly questioned in recent years. First, the rise of inequalities, especially in advanced countries, can, partly, be explained by international trade and the set-up of global value chains, suggesting that economic globalisation does not benefit all, and certainly not equally. Second, the 2008 global financial crisis was perceived by many as a by-product of globalisation and an unhealthy focus on economic profit. Third, the rise of new international actors has put the global system in question, particularly China, which has engaged successfully in geo-economic competition with the West. China has now become a key hub in international value chains and a crucial player in the technological race (especially in micro and nanoelectronics, robotics, as well as in artificial intelligence). While the world has benefited from China’s economic progress, there have been increasing concerns about its state-driven capitalism and the perceived nature and practice of Chinese competition.

**GLOBAL ECONOMIC GOVERNANCE IN DECLINE**

As a result of the longer-term global trends and recent challenges, we are seeing a change in how economic globalisation is perceived. International trade and investment are no longer perceived as a positive-sum game by many. Global interdependence has also become a geopolitical concern, given its potential to be weaponised for political purposes if overreliance on critical goods and technology from foreign partners results in systemic vulnerabilities. With its counterproductive antagonistic stance vis-à-vis all international partners, the Trump presidency was also the expression of these new trends, resulting in the US withdrawing its support from the multilateral system it had founded and shaped. While the Biden administration is very different regarding the support of the multilateral system, many of the challenges of the Trump era have persisted.

In light of the above, the international economic order is currently experiencing significant headwinds: unprecedented technological innovation, ‘my country first’ and ‘take back control’ movements, the rise of new regional players and non-state actors, as well as new societal challenges, are fuelling growing complexity and accelerating the fragmentation of the multilateral world order, for example when it comes to the ability of the World Trade Organization (WTO) to adjudicate trade disputes. COVID-19 and the war against Ukraine, with all the supply and value chain disruptions they entailed, reinforced the global paradigm shift. In sharp contrast with the free market age, we witness resurgent public interventionism in economic, industrial and trade policy.
Main challenges and opportunities

THE AGE OF ECONOMIC SECURITY

Economic security has become one of the principle objectives of public policy. Policymakers in Europe and elsewhere are mapping strategic dependencies, supporting businesses to boost the production of critical goods to accelerate the climate and technological transitions, reorienting supply chains, and deploying trade instruments more aggressively. A few years ago, the EU adopted its long-term strategy to achieve an ‘open strategic autonomy’. With this strategy, the EU aims to reduce reliance on foreign partners for critical goods and technologies, remaining open to international trade but be contextually ready to react to unfair practices, and act more autonomously in defence and security. Broadly speaking, strategic autonomy means shaping global dynamics and defending European interests.

The bond between economy and national security is even stronger now for EU member states, as the watershed brought the threat of large-scale war back to the European continent. First, sanction packages have been imposed on the Russian economy, coordinated with Western allies. Second, through RepowerEU, the block aims to end its dependency on Russian gas by saving energy, diversifying supply sources, and boosting renewable energy. Third, the EU is committed to improving its military-industrial base. It has now proposed a Procurement Act, which would enable member states to jointly procure defence technologies.

GREEN TECH COMPETITION

Paradoxically, the deterioration in global cooperation comes at a time when all countries face the common and existential challenge of climate change, which can only be addressed if countries work together. Achieving a carbon-neutral economy requires a dramatic shift in economic structures, necessitating further public investments and decisive industrial policies. China made the domestic manufacturing of clean technologies, fuelled by public funding, a national priority and now the country is a powerhouse of solar photovoltaics, wind turbines and batteries for electric vehicles.

The US Inflation Reduction Act (IRA) will direct $400 billion to reduce carbon emissions through tax incentives targeting corporations and consumers. Some provisions of the IRA foresee local content and assembly requirements, which will disadvantage producers on the other side of the Atlantic. As a reaction, the EU has eased state aid rules and envisages establishing a new common fiscal tool (also for green projects) to respond to the US plan. These developments highlight the difficulties in addressing climate change in the current economic governance system, as competitiveness, level playing field, technological sovereignty, state intervention and climate change action are all intertwined. Furthermore, in pursuit of sustainability, the EU institutions agreed on setting up a Carbon Border Adjustment Mechanism (CBAM). For a set of products, this will impose a carbon price on imported goods equivalent to the one applied to the same goods manufactured in the EU. The new mechanism should also prevent European industries from relocating to countries whose climate objectives are less ambitious than the EU’s.

THE PERMACRISIS

It will not be easy for the EU to achieve the objectives of economic security in an era dubbed by the European Policy Centre in 2021 as the “age of permacrisis”. Indeed, for the last 15 years, the EU has experienced several crises related to the global financial system, such as sovereign debt, migration and asylum, internal and external security, COVID-19, Brexit, populism and the rule of law. One challenge has seamlessly been followed by the next, straining the ability of the EU to address the subsequent crisis.

A NEW MULTILATERAL WORLD ORDER

The ongoing fragmentation of the geopolitical order started long before Russia’s war of aggression against Ukraine. Unilateral actions in the economic and political environment have shown how global governance is increasingly shaped by power politics, with a multipolar world order taking shape. Over the past years, many governments have tended towards bilateral or regional deals and issue-based cooperation rather than multilateral agreements, leading to a decline in the effectiveness of international institutions, which have not been able to adapt fully to the changing environment and challenges.

What are the consequences of this on economic interdependencies and globalisation? Globalisation will remain, and rules, national policies and interests will continue to shape economic dynamics; trade has never been entirely unrestrained. But the new tendencies described above will reshape globalisation. Like-minded partners will presumably engage in ‘friend-shoring activities’ in critical sectors and try to align trade, industrial and technology policies to face the challenges of geo-economic and political competition. The transatlantic coordination on export controls in the aftermath of the Russian invasion, the EU-US Trade and Technology Council and the Chip 4 alliance on semiconductors are cases in point.

Whether in support of a multipolar or multilateral world order, a competition for influence is unfolding. Future transformations in global governance will most likely reflect the expanding geopolitical role that some of the
most developed Asian countries are playing. From the perspective of the EU, effective global governance is required more than ever. However, there is a recognition that the global system has to change.

A ‘new multilateralism’ is needed that reflects ongoing shifts in the world economy, demography, and political power distribution.

Recommendations and conclusions

THE AGE OF ECONOMIC SECURITY

In an environment dominated by power politics, the EU has to determine its global position. Within the block, member states need to find consensus on different policy areas (trade, economic, industrial and foreign policy) and act united. If the block is fragmented along national lines, EU credibility would be undermined, and its ability to act on the international stage would be compromised.

However, a more proactive EU should not be understood to have the intention to dismantle the global economic governance system. On the contrary, the first preference for the EU is still the multilateral rules-based order. Furthermore, international economic coordination remains necessary as no country or regional block can face global challenges independently.

Firstly, countries must converge on a path leading to a sustainable planet. Those areas concern, among others, shared indicators to measure emissions in the production process and along value chains, coordination on national carbon border adjustment mechanisms and involving developing countries by providing them with key technologies to decarbonise their economies.

Secondly, industrial policy instruments, including subsidies (in the legitimate pursuit of green transition and economic security) must be framed under new common rules, leveraging the existing discussion fora between like-minded partners, namely the US-EU-Japan trilateral negotiations and the Trade and Technology Council. Those discussions must be complemented with additional exchanges with relevant actors, including China, which must be at the negotiating table.

Thirdly, COVID-19 showed that supply shortages can paralyse the global economy and threaten not only economic progress but human health and well-being. Building resilience of supply chains is important, but interdependence will remain, and nations will always rely on third partners for specific goods. Against this background, avoiding unilateral and disproportionate restrictions in the name of ‘my country first’ should represent a key objective of global economic cooperation.

More broadly, uncoordinated fiscal, monetary and trade responses to global crises may exacerbate the downside risks. This implies that countries should not abandon macroeconomic policy cooperation. A successful example was the G20 work in the aftermath of the financial crisis. Back then, countries set out a shared approach for the macroeconomic response and rejected raising new barriers and protectionist measures.

Europe must work with partners to rebuild an effective global economic governance while bearing in mind that the global environment existing before the aggression against Ukraine, COVID-19 or even the Trump presidency will not return. Moreover, the EU has to draw clear red lines: there can be no tolerance for the disregard for international law and practice that Russia has shown. Trust and cooperation are the basis of the rules-based multilateral order. While Europe remains committed to the multilateral order, this should not be misunderstood as naivety, given the era we have entered. Europe stands ready to defend its values and interests in this more contested global environment.
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Under pressure: EU-China relations in 2023

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Introduction

The relationship between the European Union and China has been deteriorating for several years but it entered a troubling new phase in 2022, following Russia’s invasion of Ukraine. Weeks before the invasion, China’s President Xi Jinping sealed a “no limits” cooperation pact with Russia’s President Vladimir Putin. Since the conflict began, Chinese officials have voiced support for the Russian narrative that the United States and NATO are to blame for the war. Despite efforts to portray Beijing as a neutral party that is only interested in peace, China’s actions have told a different story. Xi refused to speak to Ukrainian President Volodymyr Zelenskyy in the first year of the war, while maintaining regular contact with Putin and rolling out the red carpet for the Russian leader’s only ally in the war, Belarusian dictator Alexander Lukashenko. China’s ambivalent stance on an issue of paramount importance to Europe has sent a chill through the relationship. One of the clearest signs of this came at a virtual EU-China summit held in April 2022, which was later described by Josep Borrell, the EU’s top diplomat, as a “dialogue of the deaf”.

Four years after the EU labelled China a partner, economic competitor, and systemic rival, the balance has tilted toward competition and rivalry. While China’s stance on Ukraine is a primary reason for this, it is not the only one. Other contentious issues include China’s aggressive posture towards Taiwan, its human rights violations in Xinjiang, the security crackdown in Hong Kong, economic coercion against Lithuania, and the persistent imbalances in its trade and investment relationship with Europe. In 2022, China was the EU’s top trading partner for goods, but concerns were mounting about Europe’s dependence on China for critical inputs, notably on raw materials needed for the transition to a green economy.

Despite growing tensions, neither the EU institutions nor the big European capitals are comfortable with a relationship with China that is defined primarily by confrontation and conflict. As soon as China loosened draconian COVID-19 restrictions at the end of 2022 that had shut the country off from the rest of the world over the previous three years, German Chancellor Olaf Scholz and European Council President Charles Michel paid visits to China to meet with President Xi Jinping and try to get the relationship back on track. European governments remain committed to dialogue with China, and they are concerned about what a decoupling from China would mean for them, particularly when the war in Ukraine has sent energy prices soaring and continues to hurt their economies.

For geopolitical and economic reasons, China also has a strong incentive to prevent the relationship with Europe from deteriorating further. Although China’s economy is expected to bounce back in 2023 as a result of the loosening of pandemic restrictions, it still faces formidable challenges, from a crisis in the property sector and high household debt levels to an ageing population and a US-led push to restrict its access to advanced technologies. Against this backdrop, Beijing will want to preserve its access to the vast EU market and ensure that European companies continue to invest in China. It will also seek ways to prevent closer alignment between the EU and the US, which is pressing its allies to restrict their economic engagement with China. While the EU does not want to choose sides, carving out a middle path will be challenging. China’s strategic partnership with Russia will continue to stand in the way of closer ties. Additionally, the deal, clinched in early 2023 between the United States, Netherlands and Japan, to limit exports of semiconductor equipment to China highlights the risk that the EU and its member states will be pushed into zero-sum policy decisions as the US-China competition heats up.
EU–CHINA RELATIONS IN 2023

Over the coming year, EU-China relations are likely to be shaped by five main drivers.

1. **The relationship will hinge on whether Chinese authorities can ease growing concerns about their economy and the country’s attractiveness as an investment destination.** Three years of lockdowns, the growing influence of the Chinese state in the economy, and geopolitical tensions, including over Taiwan, have soured China’s image and triggered a diversification wave that is likely to accelerate in 2023. While some big European firms, notably in the auto and chemicals sectors, continue to invest in China, many others are seeking to secure their supply chains and broaden their global footprint by channelling investment to countries like Vietnam, India, or the United States. At the start of 2023, there are questions about how strong the post-COVID rebound in China’s economy will be, given unresolved structural problems and growing state intervention. In sectors like car manufacturing, once dominant European firms now face increasing competition from homegrown Chinese rivals. The economic relationship also continues to be clouded by the exchange of sanctions between the EU and China in March 2021, which put the Comprehensive Agreement on Investment (CAI) on ice. If China becomes a less attractive destination for European companies and Chinese firms continue to take market share from European competitors in the industries they once dominated, it would weigh on the broader relationship between the EU and China.

2. **The course of the war in Ukraine and the evolution of Russia-China ties are likely to play a decisive role in shaping EU-China relations in 2023.** As the war enters its second year, European leaders have made efforts to persuade Xi to use his influence with Putin to end the conflict. But, aside from Chinese warnings against a nuclear escalation in Ukraine, there are few signs that Beijing is prepared to lean on Putin. In 2022, China was careful not to run afoul of Western sanctions against Russia. But the longer the war drags on, and Russia’s economy suffers, the higher the risk that China supports Russia, brushing up against or crossing European red lines. China’s ambivalent position on the war has damaged ties with Central and Eastern European countries in particular, with all three Baltic countries leaving the 17+1 (now 14+1) format with China, and the Czech Republic and Romania possibly next in line. Looking ahead, another source of tension could be China’s role in the reconstruction of Ukraine. The United States and Europe have provided the lion’s share of support for Kyiv during the war. Together with the Ukrainian government, they are likely to set the terms for reconstruction. Will Kyiv say no to Chinese money? Probably not. But neither will there be much appetite for giving Russia’s main geopolitical partner a key role in rebuilding Ukraine’s infrastructure.

3. **A third factor will be the German government’s success (or failure) in overcoming internal differences over China policy and pushing the EU towards a more united stance.** Berlin is expected to publish a new China Strategy in the spring of 2023, but divisions between the Greens-led Foreign and Economy Ministries, on the one hand, and the Social Democrat-led Chancellery, on the other, could complicate the European debate. These divisions were brought into stark relief in October 2022 when Chancellor Olaf Scholz overruled half a dozen of his ministers who had sought to block a bid by the Chinese shipping giant COSCO for a stake in a terminal at the Hamburg port. At the centre of the debate in Berlin is how fast and far Germany should go in reducing its economic dependencies on China, including in the corporate sphere. Without clarity from Berlin and a concerted push by the German government to rally other EU member states around a common vision, Europe is likely to remain divided and reactive to developments in Beijing and Washington.

4. **A fourth driver will be policy alignment between the EU and like-minded partners, particularly the United States, on economic security and green technology issues.** Over the past year, the Biden administration has used a combination of export controls and industrial policies (the Inflation Reduction Act and the Chips and Science Act) to limit China’s access to advanced technologies and bolster its competitiveness in key sectors. In 2023, it is expected to unveil a new regime for screening outbound investments. How Europe and other like-minded allies like Japan respond to these measures will have a major impact on relations with China and the United States. Above all, it will be important for Europe to invest resources in developing its joined-up vision for economic engagement with China so that it can talk with Washington at eye level and push back against measures it sees as overly aggressive. A failure to engage proactively in the economic security debate will leave Europe in reactive mode and individual member states vulnerable to pressure – as we have seen in the case of the Netherlands on semiconductor manufacturing technology. The EU-US Trade and Technology Council (TTC) can play an important role here, as can the G7, with economic security at the top of the agenda of Japan’s presidency in 2023. This will also be a critical year for transatlantic and broader G7 alignment on China, partly because the window for substantive progress risks closing as elections in the EU and the US approach. The strong US reaction to...
an alleged Chinese spy balloon in early 2023 and the setting up of a new China-focused Select Committee in the House of Representatives show how domestic political considerations are likely to play a growing role in US policy towards China in the run-up to the election. Over the coming year, Europe can expect growing pressure from Washington to get behind its China policies.

5. The relationship between the EU and China will also be shaped by the situation in the Taiwan Strait in the run-up to a presidential election on the island in January 2024. European awareness of the risks related to Chinese military intervention in Taiwan has risen over the past year, not least because the war in Ukraine has demonstrated how quickly geopolitical tensions can erupt into conflict. With US-China tensions higher than they have been in decades and an election looming in Taiwan, we have entered dangerous territory where an accident could metastasise into a wider confrontation. In 2023, it will be necessary for European countries to agree and communicate a clear message to Beijing on the consequences of a potential conflict and ensure they are better prepared than they were for Russia’s invasion of Ukraine. That means thinking through responses along the escalation chain – from hybrid attacks to a blockade or full-blown military intervention by China – and continuing to engage with Taiwan. It will also be important to work closely with allies on messaging – a task which may be complicated by a more forward-leaning approach in Washington, particularly with Republicans setting the agenda in the House.

Main challenges and opportunities

UKRAINE ENDGAME

Beijing and Moscow both view the United States as their prime geopolitical adversary. This common cause will continue to bind them, shaping China’s stance on the war in Ukraine. This means the conflict will likely remain a source of tension in the EU-China relationship in 2023. Still, Beijing will determine through its actions whether these tensions are kept under a degree of control or whether they escalate, leading to a more decisive break with Europe. Any signs that China is ready to support Russia militarily as the war drags into its second year would do serious damage to the relationship, possibly triggering European sanctions against Chinese entities. Efforts by Beijing to engage with Ukraine, restrain Russia from a military escalation and play a more constructive role in peace efforts would be welcomed by the EU. Unfortunately, the 12-point position paper on the conflict that Beijing published in late February suggests that China is still far from addressing European concerns about its stance.

ECONOMIC DE-RISKING

Europe is in the midst of an intense discussion about reshaping its economic relationship with China. This includes a push by governments to reduce their economic dependence on China, a drive by European companies to diversify their investments to other countries in Asia, and initiatives at the government and corporate levels to make supply chains more resilient. These efforts are poised to accelerate in 2023, with the unveiling of an EU Critical Raw Materials Act, Germany’s new China Strategy, and efforts to ramp up homegrown semiconductors and green technology production. Europe is likely to come under growing pressure from the United States to take more forward-leaning steps to restrict economic engagement with China over the course of the year. At the same time, China is pushing for a revival of the EU-China Comprehensive Agreement on Investment, which has been in a deep freeze since the tit-for-tat sanctions in March 2021. Defining a broader vision for its economic relationship with China is one of Europe’s tallest tasks for the coming year.

US POLITICS

In its first two years, the Biden administration was focused on rebuilding US alliances and shoring up industrial competitiveness. It is now turning its attention to China, one of the few policy areas with a semblance of bipartisan consensus in Washington. The administration’s robust response to the Chinese balloon that floated across US airspace in early 2023 and its public accusations, made at the Munich Security Conference weeks later, that China was considering providing military support for Russia point to a more confrontational approach to Beijing, fuelled by electoral politics. The new China Select Committee in the House of Representatives will contribute to this sharper tone. As a result, the US is likely to present Europe with starker zero-sum policy choices regarding China.
Recommendations and conclusions

- **Double down on European unity**
  Germany should use the publication of its China Strategy to trigger a broader discussion in Europe about China policy, focusing on economic security. The aim should be to define guidelines for the future economic relationship and reassess the policy tools needed to ensure economic resilience.

- **Clear-eyed engagement with China**
  At a time when dialogue between the US and China is becoming increasingly difficult, EU institutions and European capitals should remain engaged with the leadership in Beijing and other Chinese interlocutors. There is value in delivering clear, consistent messages on issues of European concern, from Ukraine to Taiwan. Europe should approach this dialogue with a clear picture of its interests and aims, while guarding against attempts by China to divide the bloc through a mix of carrots and sticks applied to member states.

- **Deepen outreach to the Indo-Pacific and Global South**
  The EU should ramp up engagement with countries in the Indo-Pacific and Global South. At a time when US-China tensions are on the rise and a global battle of narratives is underway, it will be more important to exchange views, forge policy consensus and pursue economic opportunities with a broad array of countries.

- **Hope for the best, plan for the worst**
  Russia’s invasion of Ukraine caught Europe off-guard. It must ensure that the same does not happen in relation to China. This will mean working through scenarios for a Taiwan conflict and a deepening anti-Western partnership between Beijing and Moscow.
EU-China climate cooperation: Challenges and opportunities

What are the key challenges faced by the EU and China in their climate cooperation efforts? What specific areas of climate cooperation are the EU and China focusing on, and what progress has been made in these areas?
Introduction

China and the EU share a critical role in global efforts to combat climate change. China-EU climate cooperation first emerged along with the UN climate regime. Since 2005, the EU-China Partnership on Climate Change has provided a high-level political framework for cooperation and dialogue. However, the bilateral relationship has cooled significantly in recent years as European governments seek to decrease their economic reliance on China. In 2022, relations deteriorated further in the wake of the Russia-Ukraine war. In addition, European countries have also been under pressure from the US to distance themselves from China as the US seeks to decouple its economy from China.

Wang Yi, China’s State Councilor and Minister of Foreign Affairs, once described climate change as an "oasis in the desert," meaning that it was considered an area of cooperation that could be shielded from geopolitics. Despite growing tensions, China-EU climate cooperation has shown its resilience. As the EU sees China as a partner, competitor, and rival, China-EU climate diplomacy will inevitably continue amid the conflictual issues that dominate the bilateral relations.

Key issues

GLOBAL CONTEXT FOR CLIMATE ACTION

Despite increasing awareness of the urgent need to address climate change, global greenhouse gas emissions have continued to rise, and global efforts to reduce them have fallen short of what is needed to limit global warming to the goal of 1.5°C above pre-industrial levels, as outlined in the Paris Agreement. The 2022 UN Climate Change Conference (COP27) held in Sharm el-Sheikh saw the sticking point of “loss and damage”, in which China and a broad group of developing countries proposed to create a fund into which developed nations would pay. However, even within the much smaller and similar group of seven, the Sapporo meeting stopped short of endorsing a 2030 deadline for phasing out coal.

Political and economic barriers, lack of international cooperation, and insufficient funding for climate action are reasons for the slow progress. Moreover, geopolitical tensions could undermine the multilateral efforts to fight climate change. During the 2022 G20 climate talks, the participants did not manage to agree on a joint communique. In a thinly veiled allusion to China, Executive Vice-President of the European Commission Frans Timmermans said, “try and hide behind developing countries to use arguments that, I think, are no longer viable.” In response, the Chinese Ministry of Foreign Affairs stated that “as a developing country, China has always stood by a large number of developing countries and firmly defends its common interests” at the G20 talks.

CLIMATE AMBITIONS AND ENERGY INSECURITY

The outbreak of war in Ukraine made Europe’s energy crisis more acute. The huge quantities of Russian gas were part of the calculation that made the EU’s ambitious climate agenda possible. The gas crunch has necessitated a massive shift back to coal. During the crisis with Russia, the EU and its members have been implementing measures that may slow down or even reserve the energy transition in the next few years. In 2023, the EU will most likely increase its collective greenhouse gas emissions and rely on fossil fuels to compensate for its pressing energy needs.
China, on the other hand, has also been facing economic challenges to its ‘dual carbon goals’. As some Chinese energy experts point out, the country is a manufacturing giant in the middle stage of industrialisation, with a low-end industrial chain and coal accounting for 56.8% of its total energy consumption. There are still some constraints on the domestic coal and electricity supply in China while international prices for oil and natural gas remain highly volatile. Ensuring a stable energy supply is crucial for maintaining economic and social stability.1

IMPLICATIONS OF THE EU’S GREEN POLICY

To respond to the Inflation Reduction Act, which has caused significant transatlantic tensions since its signing by Joe Biden in 2022, the EU announced a major ‘Green Deal Industrial Plan’ in February 2023 to boost the competitiveness of Europe’s cleantech industry. In April, the European Parliament and Commission approved the EU Carbon Border Adjustment Mechanism (CBAM). Expected to come into force this October, CBAM will tax goods – such as cement, iron and steel, and fertilisers – that require carbon-intensive production.

In China, CBAM is widely known as “carbon barrier or tanbilei”. It is estimated that China’s aluminium and iron and steel industries would have to pay a combined 2-2.8 billion yuan in carbon tax to the EU every year. Last year, China reportedly asked the EU to justify CBAM at the World Trade Organization (WTO). At a public event focused on China-Europe cooperation on decarbonisation, Charge d’affaires of the Mission of China to the EU Wang Hongjian criticised the soon-to-be-introduced CBAM as EU’s ‘protectionist measures’.6

Main challenges and opportunities

ONGOING TENSIONS IN THE BILATERAL RELATIONSHIP

Russia’s war on Ukraine has made ongoing transatlantic cooperation on sanctions a tangible expression of EU-US solidarity. However, the 27-member bloc continues to show discord when it comes to its China policy, as the recent EU leaders’ summit revealed. During his state visit to Beijing earlier in April, French President Emmanuel Macron stressed that Europe must reduce its dependence on the US to avoid being drawn into a confrontation between the US and China over Taiwan. His comments raised eyebrows in the US, and criticism also comes from Central and Eastern European countries, who pointed out that US support is needed more than ever.7

Besides pressure from the US-China strategic competition, political trends in Europe do not seem to bode well for EU-China relations. Elsewhere across the continent, public attitudes toward Beijing have hardened. According to recent polling in 13 European countries, 34% of respondents said their views on China had worsened. 66% of those who feel that way cited Beijing’s partnership with Russia as the biggest factor. A majority of the Germans agreed that preventing Chinese geopolitical expansion and advancing human rights in China were more of a priority than promoting trade and investment.8

THE EU’S ‘DE-RISKING’ DRIVE

The EU has outlined an ambitious ‘de-risking’ strategy that puts economic security at the centre of the relationship with Beijing. Europe’s Net Zero Industry Act sets to mandate governments to mark down public tenders for renewable projects sourced from a single country that accounts for more than 65% of the EU market share for the product. Chinese solar companies have a more than 80% share of the European market across the industry supply chain. In 2022, the EU achieved a record installation of more than 40GW of solar panels after a push to replace Russian gas. That was made possible by more than doubling annual European imports of solar panels from China. This trend has prompted policymakers to acknowledge that the EU is replacing a dependence on Russian gas with one on clean technology from China.9

CHINA’S DECARBONISATION CHALLENGE

Over the past two years, climate action has played an important role in President Xi Jinping’s leadership. However, a combination of slowing economic growth, emphasis on energy security and rising geopolitical tensions are expected to pose challenges to its transition to a low-carbon economy. Coal consumption has also increased with an energy-intensive, industry-driven recovery post-COVID.

During this year’s legislative ‘two sessions’, the Chinese leadership made the principle of “establishing [renewables as the main energy sector] before tearing down [coal industry]” front and centre of decarbonisation policy. Failure to achieve a balance between the dual objectives of carbon reduction and economic growth was considered a significant obstacle to the government’s priority for the year.10
SHARED COMMITMENT TO CLIMATE ACTION AND SHARED INTEREST IN CLIMATE COOPERATION

China and the EU remain committed to multilateralism, global governance, and the Paris Agreement. Their population’s vulnerability to climate change also necessitates climate engagement between Beijing and Brussels. Climate change poses a significant threat to China’s long-term prosperity, according to a World Bank report. A new analysis by the EU’s climate monitoring service finds that the polar regions and Europe were hit hardest by global warming in 2022. China and the EU combined represent approximately a third of global fossil fuel consumption but are highly dependent on imported energy sources. These shared interests in energy and climate security are enough to warrant further cooperation. In the words of Special Advisor to EU High Representative and Commission Vice-President Josep Borrell, “there is no chance of finding a solution to global warming without a strong partnership with and engagement of China”.

GREEN TECHNOLOGIES AND DIGITAL COOPERATION

China is the world’s largest producer of wind and solar energy and the biggest investor in the energy transition. The EU also relies on China for imports or processing of materials critical to green technology – such as polysilicon used in solar panels, lithium used in advanced batteries, or neodymium used in wind turbines. So, the European Green Deal shouldn’t remain a constantly increasing expense sheet but instead should become an opportunity for the commercial success of European companies in innovating and exporting clean technologies.

Digitalisation is expected to play a tremendous role in China’s green transformation, contributing anywhere between 12 and 22% of emission reduction in the development towards carbon neutrality. The national “Overall Plan for the Construction of Digital China” proposes that positive progress should be made in the “construction of digital ecological civilisation” by 2025. Digital technology will be used to regulate the production of new energy such as wind power and photovoltaics. After 2035, the number of electric vehicles in China may exceed 300 million, requiring a great deal of digital technology support.

DIPLOMATIC CAPITAL OF BRUSSELS AND BEIJING

Europe plays a major role in the US-China competition. The bloc’s economic clout makes it an important partner for both Washington and Beijing. Brussels also has far-reaching diplomatic capital and successful experience acting as a broker in high-stakes situations where US relations are fraught, including with Iran in 2015 and after Russia’s invasion of Georgia in 2008. With US-Chinese communication less frequent, the EU’s role as interlocutor will be vital to keeping China involved with the international community on global challenges, including climate change.

The spring of 2023 saw increased European engagements with China. The reasons are clear. China could play a pivotal role in helping to end the war in Ukraine. China’s influence vis-à-vis Russia is widely believed to have consequences for the war in Ukraine and Europe, perhaps more so after China struck the deal between Iran and Saudi Arabia, which testified to Beijing’s diplomatic prowess. Following President Xi Jinping’s call with Ukrainian President Volodymyr Zelenskyy, German Chancellor Olaf Scholz invited Chinese Premier Li Qiang for talks in Berlin on 20 June. Scholz aims to enlist China as a key partner on challenges like peace and climate change, reports say.

Recommendations and conclusions

- Promote an EU-China-US G3 trilateral mechanism

In times of turbulent relations between the US and China, the EU is well-positioned to play a mediating role, helping bring together the three parties to galvanise collection action on global threats such as climate change. For example, Brussels could host a G3 climate summit where John Kerry, Xie Zhenhua, and Frans Timmermans come to the table and discuss climate issues.

- Co-explore cooperation with developing countries on climate change

Brussels can collaborate with Beijing to find sustainable solutions for green-industry investment in the developing world, such as debt-for-climate swaps to allow developing countries to pay towards climate-related projects.

- Keep windows of communication open, however imperfect

High-level strategic dialogues should also focus on implementing specific cooperative actions, such as the co-creation of a sustainable financial platform. The next EU-China high-level dialogue on the environment and climate could be an ideal starting point.

- Open dialogue on EU-China Emission Trading System (ETS) link and CBAM

Support from both parties can incentivise emissions mitigation in other areas linked to trade across the
private sector. CBAM has been expected to act as an "external incentive" for China’s national ETS to grow. Increased EU-China technical discussions can enhance capacity building and soften resistance.

- **Move CAI forward in an incremental way**

  Reaching an agreement on CAI might be nearly impossible, but achieving minor breakthroughs in trade and investment may not be. Both parties shall be open to small-scale arrangements to reduce tensions, such as concerted moves to lift sanctions incrementally.

- **Deepen exchange between experts on green cooperation**

  China’s green transition could benefit from international standards integration in which the EU is a leading player. The two sides can encourage increased expert talks on standards over carbon emission and reduction, green finance, and technology standards for renewables. In addition, a special working group mechanism can be established to promote personnel exchanges and visits.

- **Continue cooperation on sustainability projects at sub-national levels**

  The EU and its member states have carried out 43 sustainable development activities and projects in 13 cities of 9 provinces in China, covering a wide range of fields, including environmental protection, biodiversity, climate change adaptation, energy transition, architecture, design, and sustainable lifestyles. This momentum at local levels shall be encouraged.

  Can climate cooperation remain the sole area of positive development in the long term despite the tensions in other areas of EU-China relations? As both parties decarbonise their economies, they will face similar challenges that cooperation could help overcome. It remains in their interests to balance cooperation and competition. China-EU climate diplomacy cannot be promoted in a vacuum and will inevitably intersect with larger diplomatic and geopolitical contexts. Nevertheless, climate cooperation holds great potential as a basis for the continuation of EU-China collaboration in the future. By doing so, not only China and the EU, but also the whole world will benefit.

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Islands and oases: EU-China climate diplomacy in times of geopolitical challenges

Introduction

EU-China relations have undergone significant turbulences since the publication of the EU-China strategic outlook four years ago, in which the EU defined China as a ‘partner, competitor and a systemic rival’. Rivalry and competition in the trinity of the EU’s approach appear to have gained the upper hand in EU-China relations since then.

Despite the cacophony of voices advocating for different approaches to EU-China relations from both sides, they all agree that the EU and China should maintain cooperation on climate change. This is confirmed by the readouts of all recent heads of state-level meetings between the EU and China. However, there are major contradictions in how the EU and China perceive bilateral climate cooperation. Von der Leyen described EU-China climate cooperation as an “island of opportunities” in her recent speech on EU-China relations.1 China’s top diplomat Wang Yi, on the contrary, made clear that China’s bilateral climate cooperation cannot remain an “oasis in the desert”.2

Is there a way to ensure the ‘island of opportunity’ is not submerged by the rising levels of geopolitical waves or to prevent the “oasis in the desert” from being engulfed by sandstorms in EU-China relations?

Key issues

The recent report by the UN’s top climate science body made clear that we are way off track to achieve the global climate targets under the Paris Agreement, and we are seeing a continued increase in some of the worst climate impacts and extreme weather events.3 Both the EU and China have recently experienced the worst floods and heat waves in decades.

There is little reason to doubt the intrinsic value of cooperation between two of the world’s largest emitters to address climate change. It goes without saying that it is in both China and the EU’s interests to act on climate, considering the security implications of rising climate impacts and the economic benefits that can be reaped from the growing clean technology markets.

The “EU and China Partnership on Climate Change”,4 a document issued at the 8th EU-China Summit in 2005, remains the basis of EU-China climate cooperation. The partnership is supported by action plans, dialogues, and research workstreams on issues ranging from energy efficiency and carbon capture to climate adaptation and hydrogen. The commitment to climate cooperation was renewed in 2010,5 20156 and 20217 by EU-China joint statements on climate, the last of which has led to the establishment of the High-Level Environment and Climate Dialogue at the cabinet level.

Official EU-China dialogues on climate serve as coordination channels for the annual international climate talks – the Conference of the Parties (COP) under the UN Framework Convention on Climate
Change (UNFCCC). The EU and China have issued joint statements ahead of key climate conferences in the last decade, including COP21 in Paris and COP26 in Glasgow, signalling their determination to uphold their obligations to the UN’s climate agreements. These common understandings between the EU and China (and between the US and China) have helped facilitate a more cordial relationship between developing and developed countries ahead of international negotiations. This relationship has set the tone ahead of climate talks and minimised fights during the negotiations, such as the one which led to the failure of the COP15 talks in Copenhagen.

The technical dialogues and joint research projects under the EU-China climate cooperation framework have facilitated convergence between the EU and China on climate policies. Notable examples of policy convergence include China’s adoption of an EU-styled carbon emissions trading scheme and the development of an EU-China sustainable finance classification system that laid the foundations for attracting financial flows towards sustainable projects. These policy tools and shared policy expertise should, in turn, enable China to adopt more progressive climate policies.

The case for why the EU and China should work together on climate change is clear, but it does not follow that cooperation would produce the desired outcome. The current approach, mostly based on technical cooperation and high-level exchanges to deliver change, has started to show its limits:

- The scope of these technical initiatives does not address the political obstacles to the climate and energy transition. For example, energy security concerns, supercharged by the volatility of international energy markets after Russia’s invasion of Ukraine, are driving a relapse in coal power plants in China. The scope of the current EU-China climate and energy dialogues does not cover contentious climate-related trade issues, such as the implications of the EU’s carbon border adjustment mechanism (CBAM) or state aid in green energy sectors.

- The pace of policy convergence is not fast enough to keep the global climate safe. China’s official climate targets and accompanying policies are only consistent with a 3°C warming trajectory, which breaches the 2°C threshold in the Paris Climate Accord. By comparison, the EU’s official 2030 climate targets are consistent with the 2°C goal, but not with the more stringent 1.5°C target of the Paris Agreement.

- The notion that EU-China coordination on climate negotiations ahead of climate summits helps facilitate better outcomes is questionable. The pre-summit common understandings and statements have not resulted in China aligning its climate targets with the Paris Agreement. China is able to sidestep questions on its lack of ambition by pointing to the failure of Western countries to meet their climate finance obligations to developing countries. The EU is also growing increasingly impatient at the lack of offers from China. At the COP27 summit in 2022, the EU publicly called China to take responsibility for contributing to the Loss and Damage Fund, a position that Beijing considers a red line as it is under no obligation to contribute to international climate finance under the UN framework.

- Despite willingness from both sides at technical and ministerial levels to maintain dialogues on climate, they are increasingly vulnerable to tensions in the broader relationship. For example, following Nancy Pelosi’s visit to Taiwan, Beijing unilaterally suspended US-China climate cooperation, suggesting that the ‘no-oasis-in-desert’ approach takes precedence in Beijing’s view. Climate cooperation cannot prevail amid conflicts in the wider relationship.

The inability of EU-China climate cooperation to produce the desired outcomes does not warrant the end of such engagements. On the contrary, it calls for a discussion on the building blocks of effective climate diplomacy between the EU and China. EU-China climate diplomacy should be a mechanism to accelerate domestic and international climate action. This would require the EU and China to maintain the bilateral high-level and technical exchanges, address the tensions that arise at the intersection of climate action and geopolitical interests, and engage in reforms of international financial institutions to scale up climate finance.

Main challenges and opportunities

Tackling global climate change requires a fundamental transformation of our energy, trade, and financial systems. As such, EU-China climate diplomacy should touch upon all of these areas.

**ENERGY SECURITY**

For over a decade, the EU and China have shared experiences in decarbonising energy and power systems through technical cooperation on emission trading, power grid, and energy efficiency. However, the current dialogue formats are not designed to address energy security concerns in the transition. This issue has been made more acute by the fallout of Russia’s war in Ukraine.

For the EU, the war has revealed the vulnerability of fossil fuel dependence and strengthened the role of renewables in safeguarding European energy security. But it also led to short-term fallbacks on coal power in some member states and a dash for gas to replace
Russian supplies. This has undermined the EU’s climate leadership role, especially in the Global South. The weakness in its energy supply chain has precipitated a view that the EU should diversify its clean energy technology supply chain. The EU has since proposed legislation that mandates re-shoring parts of the clean tech value chain.

For China, the tightening of the global gas market amid rising tensions with the West and challenges in the domestic energy market has sharpened Beijing’s focus on energy security. Since the start of the Russian invasion, China has fallen back on relying on the dirtiest fossil fuel: coal - “as dictated by China’s resource endowment”. The significant scale of China’s coal expansion plans directly threatens the 1.5°C temperature goal of the Paris Agreement.

China and the EU should address issues concerning energy security in their existing dialogues at all levels, including those on climate, energy, and trade. These dialogues should prioritise addressing the role of renewables in ensuring energy security, securing stable green tech supply chains, and aligning policy responses to the energy security crisis with the climate goals of the Paris Agreement.

**CLIMATE-RELATED TRADE MEASURES**

The potential fallout over climate-related trade policies poses another challenge to effective EU-China climate diplomacy. The EU’s CBAM, proposed to ensure a fair price on carbon-intensive imports, has angered some of the EU’s trading partners. China, together with other emerging countries, has criticised the measures as unilateral and discriminatory, undermining trust in the multilateral frameworks. Beijing has yet to announce a response to the mechanism, which is due to enter into force later this year, but it is likely to strain future EU-China dialogues on climate and trade.

China’s dominance across most renewable technologies makes its global supply chains highly vulnerable to disruption caused by trade or geopolitical tensions. The International Energy Agency (IEA) has called upon countries to diversify their clean energy supply chain to manage these vulnerabilities. The EU has responded with a strategy to de-risk its green supply chains through re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’. The strategy has been laid out in the recently published EU Green Deal Industrial re-shoring and ‘friend shoring’.

China views these efforts with scepticism. While Chinese state-owned enterprises (SOEs) doubt that the EU can compete in solar technologies, Chinese policymakers are reportedly considering solar export restrictions to the EU if the latter moves towards a more restrictive approach on sensitive technologies transfers.

These tensions over climate-related trade measures, if not properly managed, could lead to disruption in EU-China trade and renewable technology supply chains. The EU and China should manage their competition on clean technologies and minimise the risk of supply chain disruptions through continued dialogue. Both the EU and China should ensure that the policies they put in place to compete with one another, such as export controls and re-shoring targets, do not impact the chances of the Global South from playing a role in the supply chains for renewable technologies and getting a slice of pie in the global clean economy.

**CLIMATE FINANCE AND INTERNATIONAL FINANCIAL SYSTEM REFORM**

The question of responsibility in international climate finance contributions is a potential flashpoint in international climate negotiation and another obstacle to EU-China engagement on climate. Under the ‘common but differentiated responsibility’ principle of the UN Climate Convention, rich nations should take on more responsibility to cut greenhouse gases (GHG) and should provide the financial means to support developing countries to decarbonise their economies. Despite recent progress, developed countries have not lived up to the promise to provide $100 billion to support developing countries addressing climate change. China is not obliged to make any international finance contribution, but, as China’s wealth and emissions grow, so does its responsibility. With the emergence of a new fund to address historic damages from climate impacts, the EU and some developing countries have called on China to contribute to a newly established Loss and Damage Fund. China said that it would support developing countries through a bilateral South-South Climate Cooperation mechanism. So far, China has provided only 10% of the $3.1 billion pledged for a dedicated fund for South-South Climate Cooperation in 2015, and its green investments comprise only about 2% of its overseas finance.

To mobilise the trillions needed for the global transition, the EU and China should step up their climate finance offers to developing countries. Both sides should work together to explore new and innovative sources of finance, facilitate reforms of the international financial architecture, and coordinate on debt restructuring as recently at the World Bank and International Monetary Fund (IMF) spring meetings. At the same time, they should ensure that competition over partnerships with Global South countries is managed through constructive dialogues and results in attractive development opportunities guided by partner countries’ priorities, building up production capacities and global supply chains.
Recommendations and conclusions

EU-China engagement on climate is inevitable. While China’s emissions pose a risk to European climate safety, the EU is a significant market for Chinese clean technology, and cooperation can bring innovation to both the EU’s and China’s climate policy. However, the existing bilateral mechanisms are showing their limits in accelerating climate action, and the political reality of EU-China relations is raising the hurdle for cooperation.

Effective climate diplomacy between Brussels and Beijing needs to drive accelerated climate action in the EU and China. As two of the world’s biggest emitters and aspiring ‘climate superpowers’,33 they must align climate policies with their Paris Agreement obligations and rebuild trust in the multilateral system. The EU and China should ensure that their actions to stay ahead in the clean tech race do not disrupt the climate transition globally. This would require the EU and China to review the scope of their existing engagement and establish new mechanisms to manage bilateral tensions arising from their domestic and international climate policies. Specifically, the EU and China should:

**RENEW THE COOPERATION**

- **Review the scope of the EU-China climate and energy dialogue in response to emerging obstacles in the climate transition**

  In particular, the EU-China High-Level Environment and Climate Dialogue should go beyond an exchange of views on emissions targets and a health check on domestic climate policies. It should be expanded to include discussions on the role of renewables in energy security and the systemic risk that climate impacts pose to food systems and regional security. These discussions can be underpinned by new technical initiatives, for example, as part of the EU-China Energy Cooperation Platform, and tackle emerging challenges for the transition, such as a pricing system for reserve capacity in the power market and the socio-economic impacts of the energy transition.

- **Work together to unlock the fiscal space for third countries’ climate transition**

  The combined effects of COVID-19, the inflationary impact of Russia’s war and an appreciating dollar have squeezed the fiscal space for many developing countries, limiting their ability to fund the climate transition. The EU and China should engage in consultations on how they could jointly unlock fiscal space in developing countries. This could include issues related to capital adequacy reform - recommended by a G20-commissioned report34 - to boost the investing capacity of multilateral development banks as well as a new North–South finance pact on climate and development, which will be discussed at the Summit for a New Global Financial Pact in June 2023, hosted by France.

**MANAGE THE COMPETITION**

- **Mainstream climate into EU-China high-level dialogues**

  Climate needs to be on the agenda of all relevant dialogues on trade, economy, and energy between the EU and China. This will allow both sides to manage tensions from the CBAM and industrial policies (e.g. NZIA and CRMA) on clean technology sectors.

- **Engage in a race to the top on climate finance**

  To encourage China to step up in climate finance, the EU should make competitive finance offers to developing countries. This would require the EU to forge a coalition of countries to define a path ahead for the Loss and Damage Fund and to double climate adaptation finance by 2025. At key multilateral moments in 2023, such as the Financial Pact Summit, the third Belt and Road Summit and COP28, China should lay out a clear roadmap to deliver the pledged $3.1 billion fund for climate cooperation with the Global South and its promise to support renewable energy growth in developing countries. That would earn China diplomatic clout and pressure Western donors to raise their stakes on climate finance.

- **Engage in a responsible competition to secure stable clean technology supply chains**

  Any export ban on clean energy manufacturing technology or critical mineral deals with developing countries that is limited to mineral extraction will not support emerging economies to move up the clean tech value chains. The EU and China should ensure the measures to increase their edge in clean energy supply chains are complemented with offers to developing countries to grow their clean industry sectors. This would not only help increase resilience in clean tech supply chains, but also provide economic incentives for developing countries to accelerate their climate transitions and “lock in” support for higher climate ambition.
EU-China cooperation in health

What are the key areas of cooperation between the EU and China in the field of health? How have the EU and China collaborated in addressing global health challenges, particularly in the context of pandemics such as COVID-19? What initiatives or agreements have been established to promote health cooperation between the EU and China?
Analysis of China-EU health ties

Introduction

China-EU health cooperation refers to the exchange of people through government departments, researchers, health institutions, enterprises, and other sectors to develop policy recommendations to solve current health problems and support future health cooperation between the two sides. China-EU health cooperation covers both bilateral and multilateral levels. At the bilateral level, China, the EU, and its member states have explored health issues of common concern from policy and industry perspectives, including pharmaceutical industry cooperation, health system reform, chronic disease prevention and other issues. At the multilateral level, China and Europe actively participate in global health governance, mainly based on the platform of the World Health Organization (WHO), to jointly address global health challenges and explore solutions to global health challenges.

Key issues

THE COMMON OBJECTIVES OF SINO-EUROPEAN HEALTH COOPERATION INCLUDE:

- **People-centered approach**: China and Europe prioritise the health and well-being of their people, build an efficient modern healthcare system to improve people’s health standards, and are committed to improving people’s health status and quality of life.

- **Mutual development**: Sino-European health cooperation emphasises win-win cooperation and aims to strengthen partnerships and jointly promote the development of health care.

- **Health equity**: Sino-European health cooperation upholds the principle of health equity, ensuring everyone has access to health services by promoting the equitable distribution of health resources.

- **Scientific innovation**: China-Europe health cooperation values scientific innovation, promotes research cooperation, and encourages medical technology innovation and development.

- **Global health governance**: Sino-European health governance emphasises global cooperation, promoting international health exchanges and collaboration, and contributing to global public health efforts.

GUIDELINES FOR CHINA-EUROPE HEALTH COOPERATION

In 1995, the EU released its first policy paper on China—"A Long-term Policy for China-Europe Relations", which pointed out the importance of EU cooperation with China on health issues. In 2003, China specifically mentioned China-EU health cooperation in its first EU policy document. At the 16th annual summit held in 2013, China and the EU jointly adopted the "EU-China 2020 Strategic Agenda for Cooperation", in which the two sides decided to expand dialogue and exchanges in health, including through cooperation with the WHO, especially in the areas of antimicrobial resistance, e-health, cancer prevention and drug regulation, to ensure the health and safety of citizens. The 2018 China-Europe policy document points to strengthening dialogue and exchange of health policies between China and Europe and
carries out practical cooperation in areas such as health promotion, antimicrobial resistance, medical informatics, and joint promotion of food safety. Under the Horizon 2020 programme (2014-2020), the EU and China have identified five flagship initiatives, one of which is Biotechnologies for Health and the Environment.

CHINA-EUROPE HEALTH COOPERATION MECHANISMS

China-Europe Health Dialogue: this is a regular high-level health dialogue between the Chinese government and the European Union, which aims to strengthen communication and cooperation between the two sides in health. Examples include the EU-China Health Summit; cooperation between the Chinese Center for Disease Control and Prevention (China CDC) and the European Centre for Disease Prevention and Control (ECDC) since 2007 under the Memorandum of Understanding; and the China-Europe Health Networking Center funded by Horizon 2020.

China-Europe Hospital Alliance: this alliance was jointly initiated by the National Health Commission of China and the European Commission to promote exchanges and cooperation between hospitals and improve the quality of medical care and services. The secretariat of China-Europe Hospital Alliance is located in the China Hospital Association Alliance, which has attracted the participation of well-known hospitals from over 30 European countries and more than 60 major hospitals in China.

China-Europe Healthy Cities Alliance: jointly initiated by the National Health Commission of China and the European Commission, the alliance aims to promote exchanges and cooperation between cities on health and improve the health of urban residents.

China-Europe Dialogue on Drug Supervision: jointly initiated by China’s National Medical Products Administration (NMPA) and the European Commission, this dialogue aims to strengthen communication and cooperation between both sides on drug regulation.

China-Europe Joint Research Center on Antimicrobial Resistance: this was jointly established by the Chinese Academy of Sciences and Ghent University in Belgium and aims to strengthen cooperation between China and Europe in antimicrobial resistance research.

MAJOR ACHIEVEMENTS OF CHINA-EUROPE HEALTH COOPERATION

Disease prevention and control: China and Europe have worked together on infectious diseases, chronic diseases, and non-communicable diseases, jointly developing and implementing prevention and control measures. For example, on the multilateral cooperation platform, the most typical case of China-EU health cooperation is on poliovirus, known as polio. With the advice and support of the WHO, the European Union has cooperated with the National Health Commission of China. It conducted two rounds of polio immunisation campaigns targeting 3.8 million Chinese children under 15. The immunisation campaign had a positive impact. During the Ebola virus outbreak in Africa, China and Europe provided support and assistance through medical supplies, personnel, and technology.

Under the China-Europe bilateral cooperation platform, many cross-border public health cooperation projects have been implemented. The EU has provided €4.5 million in funding for China’s AIDS prevention work from 1994 to 2001. China and Europe have set up six regional training centres at the provincial level to provide technical assistance to medical staff within AIDS prevention. The EU is helping China’s medical institutions at all levels to build their capacity to deal with AIDS.

Medical research: China and Europe have conducted many joint medical research projects to explore ways to treat and prevent diseases. The establishment of the China-Europe Joint Research Center for Antimicrobial Resistance has provided a platform for China and Europe’s cooperation on antimicrobial resistance. China and Germany have also implemented multi-level health cooperation projects. The Chinese Center for Disease Control and Prevention held training on the data collection system of the project “Research on Early Symptom Monitoring and Risk Assessment Methods of Sino-German Occupational Health Hazards”, which is the first cooperation between China and Europe in the field of occupational health.

Training of health professionals: China and Europe have cooperated in training health professionals, promoting exchanges and cooperation in medical education. For example, the China-Europe Hospital Alliance has facilitated the exchange of experience and doctors between hospitals, promoting the transfer and learning of medical knowledge and skills. An agreement has been reached on an exchange plan for outstanding young researchers in the field of health between China and France in 2023.

Construction of healthy cities: China and Europe have been cooperating in urban health construction, promoting the improvement of urban residents’ health and the improvement of urban health environments through mechanisms such as the China-Europe Healthy Cities Alliance. The China-Europe Health Industry City is a key construction project for Henan Province in 2020. The construction aims to connect and share global medical resources and improve the medical services in Zhengzhou and the surrounding urban agglomeration. Under this goal, the China-Europe International Hospital project has been carried out in cooperation with the Paris Public Hospital Group in France.
Main challenges and opportunities

CHINA AND EUROPE COOPERATE WITH THE WORLD HEALTH ORGANIZATION

As major member states of WHO, China and Europe provide comprehensive support and assistance to WHO's work, including in global health, vaccines and immunisation, pharmaceuticals and health systems and services. They are jointly committed to promoting the development of global health security and strengthening cooperation in preventing and controlling infectious diseases. However, it is worth noting that the WHO is strengthening its authority and imposing more restrictions and constraints on nation states through revisions to the International Health Regulations (IHR). The proposed changes to Article 12 of the IHR will significantly expand the executive powers of the WHO Director-General to declare global public health emergencies and further centralise this power by removing the need for consultation and agreement with the state party concerned. The proposed amendments to the IHR will be proposed to the World Health Assembly (WHA) in May 2023. The need for the EU and China to reach a consensus on revising the IHR and the Panel Agreement has become an urgent issue for discussion.

IN Responding to the Russian-Ukrainian Conflict and Post-War Reconstruction in Ukraine, China-Europe Health Cooperation Can Have an Important Role.

Both sides could provide humanitarian assistance to those affected by the conflict, including medical supplies and equipment, as well as funding for health services. In addition, they could support the Ukrainian health system by providing training and technical assistance to health workers and facilitating efforts to address the mental health needs of those affected by the conflict, including counselling and other forms of psychosocial support.

Preventing the spread of infectious diseases can be a significant risk in conflict situations. Also, they could assist in rebuilding Ukraine's health system, including by providing funding for developing health infrastructure.

CHINA AND EUROPE NEED TO EXPLORE THIRD-PARTY HEALTH COOPERATION MODELS IN AFRICA

China and Europe support disease prevention and control in African countries by providing technical assistance, personnel training, medicines, and vaccines. China has established a cooperation mechanism for its hospitals to partner with 30 African hospitals and has completed the project "China's Aid to the African Union African Centre for Disease Control and Prevention Headquarters (Phase I)". The COVID-19 epidemic has exposed the inability of the African region to vaccinate due to a lack of medical resources. The low vaccination coverage in Africa is due to the short shelf life of vaccines, inadequate cold chain storage facilities in African countries and the lack of basic medical construction. China and Europe should help African countries strengthen their health infrastructure through aid, technology transfer and other means to improve their medical level. China and Europe can set up health cooperation platforms in Africa to facilitate technical exchanges, personnel training and supply medicines and vaccines.

CHINA AND EUROPE FACE MANY COMMON PUBLIC HEALTH CHALLENGES

China and Europe have the motivation and foundation to further strengthen cooperation. China and the EU face many common challenges in the ageing population, prevention and treatment of major diseases, medical system reform, and food safety. China and the EU can further strengthen joint scientific research through cooperation in deepening medical and health system reform, medical procurement, medical services, antibiotic resistance, digital medicine and information technology construction.

China is actively promoting high-level opening-up and increasing the attraction and use of foreign investment, which has brought new opportunities for China-Europe health cooperation. In 2022, China's State Council agreed that the National Development and Reform Commission and the Ministry of Commerce should publicly issue Regulation No. 52, which fully released the "Catalogue of Industries Encouraging Foreign Investment (2022 Edition)". This includes nearly 100 projects related to the medical industry. Chinese and European entrepreneurs need to pay more attention to China's healthcare industry, provide more funding and use commercial and private forces to further promote the construction and development of basic healthcare in China.
Recommendations and conclusions

In conclusion, China and Europe should continue to consolidate bilateral and multilateral health cooperation mechanisms, such as dialogue, joint research, professional associations, and academic exchanges. As major participants in global health governance, the EU and China not only provide global health public goods but also play a crucial role in leading the concept of global health cooperation and improving the mechanism of global health cooperation.

With regard to the concept of global health cooperation, China proposes to work together to build a “global community of health for all”. In March 2020, Chinese President Xi Jinping first proposed this initiative during a telephone conversation with French President Macron. The COVID-19 pandemic has highlighted the importance of the ‘Health Community’. China and the EU must continue to firmly defend multilateralism, oppose unilateralism, and jointly contribute to safeguarding global public health and security.

In building global health cooperation mechanisms, China and Europe can engage in dialogue through health institutions, promote joint research projects to explore medical and health issues of common concern, support members of the Chinese Medical Informatics Association (CMIA) to strengthen communication with the European Health Emergency Preparedness and Response Agency (HERA), participate in the European Union’s Global Health Policy Forum and learn from the experience of the European Union Early Warning and Response System (EWRS).

At the bilateral level, dialogue with the Health Security Committee (HSC), composed of health ministers and relevant government officials from Member States, should be maintained to expand more health exchanges between China and EU member states. The EU and China should launch a new round of health cooperation as one of the new flagship initiatives under Horizon Europe. In the long term, the EU and China could consider further raising the profile of health issues on the agenda of the EU-China political dialogue.

At the multilateral level, China hopes to work with Europe on the World Health Organization platform to promote and improve long-term global public health security mechanisms, threat monitoring, early warning and joint response mechanisms, and resource reserves and allocation systems.

It is necessary to take a long-term view and prepare for a rainy day. The EU and China have gained a wealth of lessons and experience in responding to the COVID-19 epidemic, including strengthening international cooperation, policy coordination and information sharing, scientific prevention and control, health education and public participation, and strengthening public health system building. But this may not be the last time that a major public health emergency strikes out of the blue. This experience will guide future health cooperation and public health development between China and Europe.

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EU-China health relations after the pandemic

10 May 2023

Introduction

In December 2019, scientists in China identified a new contagious viral disease: the respiratory syndrome Coronavirus 2 (SARS-CoV-2). Soon the world would become confounded by this virus – later commonly known as COVID-19 – raging through Wuhan. In less than two months, foreign cases rapidly increased. Even before the World Health Organization (WHO) officially declared it a pandemic in March, Europe became aware of the severity of the crisis. Consequently, China and the EU implemented a series of lockdowns, developed vaccines, and carried their economies through a global health crisis. The epidemiological dust has now settled. However, it is crucial to assess the role of governments and other essential health stakeholders and how the pandemic impacted their interactions.

This paper considers four challenges to further reflect on the evolving Sino-European health relationship. Rather than providing a reason for increased cooperation, the pandemic intensified competition and competitive narratives, severely affecting the Sino-European relationship and their stance in multilateral organisations.

Main challenges and opportunities

INDUSTRIAL COMPETITION

In April 2020, then-Chinese Foreign Affairs Minister Wang Yi delivered a speech emphasising the global nature of the pandemic crisis and China’s role in instigating international cooperation. Minister Wang Yi remarked that “China shouldered its responsibilities and provided strong support to other countries” and “Aid from China”, together with the already well-known ‘Made in China’, provided a steady driving force for the global efforts in fighting the virus.1

The fact that “Aid from China” was indeed “Made in China” faced increasing resistance by the EU and its member states, as Chinese health diplomacy not only exposed the structural vulnerabilities of the EU crisis response mechanisms but also brought to light the painful economic dependency on Chinese medical imports. This pressured the EU into pursuing ‘strategic autonomy’ within health.

With China becoming the major exporter of personal protective equipment (PPE)2 and active pharmaceutical ingredients (API)3 to the EU over the past decade, the EU has become increasingly reliant on Chinese imports in the health sector. This has triggered the EU to explore further possibilities to increase its strategic autonomy. A first assessment report defined the health ecosystem as a strategic area, specifically pointing at the EU’s dependence on APIs and health supply chains.4 The aim of building the EU’s self-sufficiency in health was also reiterated in the first EU Pharmaceutical Strategy, published in November 2020.5

At the same time, China is also attempting to diverge from its role as the world’s leading supplier of upstream APIs and wants to become a major player in developing downstream, high-end research-based biopharmaceutical products. Already in 2015, biopharmaceuticals and high-performance medical devices were identified as one of the ten priority sectors of the renowned strategic
plan, "Made in China 2025". The call to rewire the Chinese biopharmaceutical industry focus from generics towards innovative pharmaceuticals was reiterated in the "14th Five-Year Plan for the Development of the Pharmaceuticals Industry", published at the beginning of 2022. The Achilles heel of the Chinese biopharma industry, however, is its research capacity, which is still lagging behind the EU. To this end, China is also re-evaluating its position on Intellectual Property Rights (IPR) incentives.

**INTELLECTUAL PROPERTY**

To build an innovative biopharmaceutical sector, China adopted amendments to its Patent Law in October 2020. Moreover, the Chinese State Council released the "Outline for Building a Powerful Intellectual Property Nation (2021-2035)", expanding targets for contributions from local patents and strengthening IP enforcement, thereby responding to the calls made by the European pharmaceutical industry.

While on the domestic front, the Chinese government has moved towards strengthening IP protections, on the international front, China has expressed its support for waiving IP rights. In the World Trade Organization (WTO), China largely stayed on the side-lines of the debate on the waiver of the intellectual property of the COVID-19 vaccines (TRIPS Waiver), letting South Africa, India, the US, and the EU (colloquially referred to as 'the Quad') take the initiative. Initially, China was neither a proponent nor a cosponsor of the proposal. Still, China eventually supported the agreement presented by the Quad at the Twelfth Ministerial Conference (MC12) in June 2022.

By refraining from taking a stand in the TRIPS Waiver debate, China - a major exporter of COVID-19 vaccines - could continue to support its domestic intellectual property reform while avoiding an ideological confrontation with the countries of the Global South. Furthermore, while there was a convergence on the specific issue of the TRIPS Waiver, the implicit dynamics at play point towards increased competition with the EU regarding innovative biopharmaceuticals.

**PANDEMIC TREATY**

To embed pandemic preparedness in international law, throughout 2021, the European Union has spearheaded an initiative for a global pandemic treaty. The WHO applauded this landmark treaty, with its Director General Dr Ghebreyesus calling it "the best thing we can do that can bring a political commitment of member states." By December 2021, WHO members – including the EU and China – reached a consensus to start the drafting and negotiation process.

However, it is still far from certain whether an agreement will be reached. While a multilateral approach to global public health might trigger increased cooperation, there needs to be backing from other major powers, including China, the US and Russia. These countries are reluctant to hand more power to the WHO, which they perceive as confining their national sovereignty.

An enhanced agreement could, for example, enforce pandemic response compliance. This would give treaty signatories the ability to independently trigger investigatory visits and data verification – just as the International Atomic Energy Agency can execute 'special inspections' when it considers that information made available by the state in question is deemed inadequate. Embedding similar investigatory mechanisms in a pandemic treaty is met with resistance from China, Iran, and Russia, as these countries see them as infringements of their national sovereignty.

Alongside the discussions on a pandemic treaty, governments are working within the WHO towards an amended version of the International Health Regulations (IHR). The IHR create rights and obligations for countries, including the requirement to report to the WHO public health events with risk of international spread. The US is leading the way in revising this regulation, as they submitted the initial proposal to amend the IHR in January 2022. Thus far, only 16 state parties have submitted proposals for amending the IHR.

The IHR are an instrument of international law that is legally binding on 196 states' parties, including the 194 WHO member states. While a pandemic treaty would require a qualified majority in the World Health Assembly, IHR reform only needs a simple majority.

**VACCINES**

The release of the genomic sequences of the SARS-CoV-2 virus in January 2020 triggered numerous pharmaceutical companies to develop vaccines and treatments. Two pharmaceutical companies successfully developed vaccines in China: Sinopharm and Sinovac Biotech. In the EU, Germany-based BioNTech developed a vaccine based on mRNA technology, partnering with American biopharmaceutical giant Pfizer.

In March 2020, the Chinese pharmaceutical company Fosun Pharma announced a strategic collaboration to manufacture BioNTech’s mRNA vaccine in China, to supply mainland China with the most effective COVID-19 vaccines, using mRNA technology, instead of the Chinese ‘whole inactivated virus’ technology. Even though Hong Kong granted full approval and Macau granted emergency use authorisation, the BioNTech-Fosun agreement failed to materialise in mainland China as the Chinese health authorities never approved the mRNA vaccine. In parallel, in October 2022, negotiations between the American mRNA vaccine manufacturer Moderna and Chinese authorities came to a halt when Moderna refused to hand over core intellectual property rights, fearing a technology transfer.
During a visit to China, German Chancellor Olaf Scholz convinced President Xi Jinping to offer BioNTech/Pfizer vaccines in China. However, only German nationals in China are eligible for the Pfizer/BioNTech vaccine. As a result, despite several agreements and pushes from the European side – business and governments alike – China has failed to deliver mRNA vaccines, which are widely considered the most effective, to the Chinese population.

Recommendations and conclusions

Over the past two years, the EU-China relationship has been marked by mutual misgivings regarding the sincerity of each other’s efforts in combatting the pandemic. These apprehensions were fuelled by European concerns about the transparency of data and fear of intensified dependence on Chinese imports. Also, on the Chinese side, this angst tendency was reflected by an unwillingness to import mRNA vaccines and work together towards a global pandemic treaty. Furthermore, the window of opportunity for increasing bilateral health cooperation initiatives – let alone European subscriptions to Chinese-led gambits like the Health Silk Road – has decreased significantly. Considering the scars left by the pandemic, it would be naïve to believe that health would become an area of cooperation free from economic and geopolitical tension, despite convergence on intellectual property.

Global health matters should not fall victim to an increasingly hostile international environment. It is in the interests of China and the EU to strengthen ties regarding common threats, such as pandemics. Therefore, global health should be considered a de-risked area for cooperation between the EU and China. Both parties can offer a conducive environment for information and data exchange on looming health threats and effective pandemic mitigation efforts.

Both China and the EU should continue working together on the multilateral front. While an agreement on a pandemic treaty seems like a distant reality, the possibility of another outbreak is much closer. Hence, both parties need to step up their role in the WHO to increase global pandemic preparedness efforts.

To conclude, six policy recommendations can be made for Sino-European health cooperation:

- **De-risk health cooperation**: pandemic preparedness, prevention, and health cooperation should be considered a de-risked area for collaboration, isolated from geopolitical confrontation.

- **Time is of the essence**: quick development of safe and effective vaccines could be considered a triumph in the most recent pandemic. This was due to the effective transfer of genomic data from the Chinese scientific community at the early stage of the pandemic and a successful commitment by the Western pharmaceutical sector to develop mRNA technology. An early genomic data transfer mechanism should be set up to ensure genomic data can be transferred to the global medical community more swiftly than in 2020.

- **Increase data sharing**: advances in gene sequencing have allowed scientists to trace and monitor COVID-19 more than previous epidemics, still; gaps in data have remained. Therefore, it is important that surveillance capabilities are enhanced, and data exchange is promoted rather than being hampered by competing political or economic interests.

- **De-politicise vaccines and therapeutics**: global distribution of safe and effective vaccines and therapeutics should take precedence over the country of origin. Decisions should be made on a global cost- and quality-assessment basis.

- **Global distribution**: whereas China and the EU were eventually able to develop vaccines and expand their domestic response capacities, other countries – particularly in the Global South – were for too long left in limbo. When China and the EU reverted to Global South countries, national interests and vaccine diplomacy took priority over a just and timely distribution of humanitarian aid, PPE, vaccines, and therapeutics. Developing a just and effective pandemic response capacity distribution model on a multilateral level should be a paramount objective.

- **Multilateral cooperation**: China and the EU should continue their dialogue within the WHO on setting up a solid pandemic treaty as a framework for stronger multilateral health cooperation in a future health crisis.
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