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Wilfried Martens Centre for European Studies

European View
1–9
© The Author(s) 2023
DOI: 10.1177/17816858231206010
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Walking on eggshells: The twin transition and Europe's quest to de-risk from China

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Abstract

In March 2023 European Commission President Ursula von der Leyen presented the term 'de-risking' in the context of the EU's future engagement with China. This article examines how Europe should de-risk from China, scrutinising some of the European policies, actions and challenges behind this term and the newly launched European Economic Security Strategy. The article also examines how the EU should counter Chinese activities and narratives, in third countries as well as in Europe, while increasing its own engagement in countries which are crucial for the EU's (twin) digital and green transitions.

The article concludes that the EU should (1) fully implement its current trade instruments before creating new ones; (2) develop a comprehensive method and clear criteria for a common and holistic risk assessment of China; (3) communicate its goals in a transparent manner, especially to those countries and partners which are needed for the twin transition; and (4) refocus its financial instruments to develop concrete meaningful projects in these key countries, either bilaterally or together with other like-minded countries.

Keywords

China, De-risking, EU, Economic security, Green and digital transition

Introduction

The Covid-19 pandemic and the Russian war on Ukraine have laid bare the downsides of a globalised world. In early 2020 the WHO (2020) warned that the disruption to the global supply of personal protective equipment—caused by rising demand,

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panic buying, hoarding and misuse—was putting lives at risk. Thus, to make supply chains more autonomous, it recommended that nation-states created incentives for industries to increase production. Similarly, in 2022 the European Council (2023b) assessed that the Russian war on Ukraine would have a negative impact on the global energy and food markets, as well as on the mobility of people and goods, leading to shortages and higher prices for consumers.

These major events are often used to illustrate Europe's dependencies in critical sectors such as energy and healthcare. As a result of these shocks, the EU has developed several regulations and instruments which aim to increase the 'open strategic autonomy' of the Union. While this seemingly contradictory and country-agnostic term is being debated by academia (e.g. Damen 2022), it seems obvious which countries are the focus of these regulations: during the Covid-19 pandemic the EU was dependent on Chinese manufacturers of personal protective equipment, and at the start of the war in Ukraine, the EU was dependent on Russian energy imports. In an effort to diminish these dependencies on China and Russia, European Commission President Ursula von der Leyen (2023) has stated that Europe must become less dependent on a singular supplier when it comes to key technologies, energy supplies and raw materials.

This effort is a marathon rather than a sprint. Take, for example, raw materials. Currently, China supplies the EU with 98% of its rare earth, 93% of its magnesium and 97% of its lithium needs. These are key materials needed for Europe's green and digital transitions. Similarly, before the war in Ukraine, Russia was Europe's largest supplier of natural gas (45% of consumption; Kardaś 2023) and a major supplier of crude oil. Since the outbreak of war, Europe has largely managed to cut its dependency on Russia. However, as illustrated above, European dependencies in relation to China remain considerable.

Focusing on EU–China relations, this article will examine how the EU understands de-risking and assess some of the pitfalls associated with it. Concentrating on possible solutions, the article will provide recommendations for European decision-makers.

De-risking: old wine in a new bottle or a genuine policy change?

'De-risking', a term previously associated mostly with the banking world, became a buzz-word in Brussels after Ursula von der Leyen (2023) gave a speech on the future of EU–China relations prior to her visit to China with President Macron. Since then, the word has been adopted by many non-European countries, and in May 2023, the G7 leaders incorporated the word into their Hiroshima Leaders' Communiqué (European Council 2023a).

As Gewirtz (2023) points out, 'de-risking' sounds more moderate than 'decoupling', which was used by, among others, the Trump administration. In reality, the term leaves a lot up to interpretation. One might argue that the word is as vague in meaning as the EU's approach is to China, which it classifies simultaneously as an economic competitor, a systemic rival and a partner in its current China strategy (European Commission 2019). This somewhat contradictory approach allows EU member states room for manoeuvre.

As the term is not well-defined, it may be more helpful to focus on concrete policies to assess where EU relations with China are heading.

Defining 'de-risking': from whom or what do we de-risk, why and how?

Hefele, Welle et al. (2023) propose five projects for the future of EU–China relations. These include an assessment of critical vulnerabilities; the de-risking of economic relations, while decoupling where necessary; the development of an effective anti-coercion trade tool; making better use of anti-dumping tools; and enforcing measures against intellectual property theft and the exploitation of EU data.

While acknowledging that the projects introduced by Hefele, Welle et al. are meant as examples for future policies, I argue that the future scope of EU–China relations should be seen through a broader lens. Alongside technical, economic, trade and data issues, other parts of the European way of life will also be affected by the increasing tensions with the People's Republic of China. Hefele, Welle et al. concentrate their examples in policy areas that fall within the competences of the EU. Nevertheless, the increasing tensions will also be present in policy areas which do not fall under the competences of the EU, but are dealt with primarily at the national or regional levels. For example, in the domain of education, Europe has witnessed a discussion on how China, Taiwan and the 1989 Tiananmen Square protests are depicted in school textbooks. A second example comes from the domain of defence, where Germany and the UK have had domestic discussions about how to deal with retired military staff who now work as consultants for Chinese soldiers. As illustrated by Heinemann (2023), there might be a need to change national laws and regulations, at least in Germany. We can already see how China's global influence is shaping the information space in Europe. Airlines who want to do business with China and often have connections to Taiwan, do not want to name Taiwan as a country on their websites (Wee 2018). Using the same economic argument, film producers and publishers also refrain from angering China (Jennings 2022). These examples support the idea of having a broad approach to China that is not just focused on the economic aspects.

On the European level there are already several legislative proposals and instruments which, often without naming China directly, can be seen as part of Europe's de-risking efforts. These cover several of the areas mentioned by Hefele, Welle et al. (2023), and include the Critical Raw Materials Act, the Net-Zero Industry Act, the Anti-Coercion Instrument, the International Procurement Instrument, the Foreign Subsidies Regulation, the Due Diligence Directive and the Foreign Direct Investment Screening Mechanism. Moreover, the EU also aims to de-risk from China by concluding new trade deals with its global partners, including New Zealand, Australia and the Mercosur[1] countries.

The EU has also become more active in areas with which it is not traditionally associated, namely education and countering disinformation. In 2022 the Commission presented its Guidelines for Higher Education Institutions on Foreign Interference (European Commission 2022b). In 2023 the European External Action Service (2023) released its first report on Foreign Information Manipulation and Interference, naming both China and Russia as threats while recommending countermeasures on multiple administrative levels. These two examples from the fields of education and countering Foreign Information Manipulation and Interference illustrate the roles the EU can take on in areas which are not within its core competences, namely collecting information, and advising and guiding other European actors.

The above-mentioned examples show how the opportunities and challenges caused by the currently deteriorating EU–China relations affect all administration levels. Thus, the assessment of risks should also be carried out in cooperation with these different levels. Without understanding the scope of the challenge, it is difficult to develop feasible solutions. This is where the newly released European Economic Security Strategy (European Commission 2023) falls short. In it, the Commission suggests a joint assessment of the risks together with the EU member states, but it does not go into detail about the criteria or methods to be used. Nor does it clearly state which actors can contribute to the assessment or how. Moreover, the assessment will focus on the economic risks, rather than taking a holistic view.

As EU–China relations are multifaceted, cover several policy fields, and cross-cut local, regional and European competences, Europe's approach should be equally comprehensive and well-coordinated. This is equally, if not more, important when it comes to the EU's external relations with other third countries.

De-risking and the battle of narratives

When it comes to raw materials, alternative markets and alternative supply chains, both China and the EU compete for influence in the developing world. Such influence is achieved either by taking concrete action or by narrative building, with the ideal being a mix of the two. This section focuses on narrative building in the developing world and in Europe, exploring some of the Chinese and European policies, discussions and actions that have anchored these narratives in the political context.

As noted by Svedrup-Thygeson (2017) and others, China has invested heavily in building new bilateral relations and multilateral China-centric networks in the 'developing world', focusing not only on Africa, but also on Latin America, South-East Asia and the European neighbourhood. It is doing this through elite capture, making investments and loans through its Belt and Road Initiative, and shaping the public narrative.

The EU's response to an increasingly inward and protectionist China has been slow, partly because the Union sees itself as a defender of free markets and the rules-based international order. Thus, it is less willing to formulate policies that might seem protectionist. An example: China announced its ‘Made in China 2025’ strategy in 2015, in which it stated its aim of raising the domestic content of its core components and materials to 70% by 2025 (Wübbeke et al. 2016). In contrast, it was not until 2023, almost a decade later, that the EU formulated similar goals in its Net-Zero Industry and Critical Raw Materials Acts. It is also notable that in Europe, and especially with regard to the Net-Zero Industry Act, these policies have been seen as a response to the US Inflation Reduction Act, rather than as a response to Chinese policies.

Similarly, Europe has been struggling to develop its own offer for global partners. After launching its ‘Connecting Europe and Asia’ strategy in 2018, the EU announced its ‘Global Gateway’ strategy in 2021. Through this strategy, the EU wants to mobilise €300 billion of investments for high-quality infrastructure, ‘respecting the highest social and environmental standards, in line with the EU’s values’ (von der Leyen in European Commission 2021). In reality, the EU’s engagement in the developing world is guided by a complicated web of different interests. For example, as Puspitasari (2023) calculates, the EU is currently financially more invested in Afghanistan than it was before the Taliban takeover. This non-financial development assistance and humanitarian aid is flowing despite the fact that the de facto government of Afghanistan has closed educational institutes and prohibited the education of girls.

The EU’s narrative about a values-based global outreach has also come increasingly under fire from China’s propaganda machinery. As pointed out by Svedrup-Thygeson (2017), China flanks its engagement in the developing world with an anti-colonial narrative, which often portrays European engagement as neo-colonial or imperialistic, while painting a positive picture of China’s economic rise and South–South cooperation. More recently, Chinese public media outlets have also depicted European leaders, such as the Norwegian NATO Secretary General Jens Stoltenberg, as speaking for the US instead of Europe (*Global Times* 2022). By doing this, China aims to highlight inconsistencies, or what it calls ‘double standards’. This line of argument aims to put Europe on the defensive, explaining its wrongdoings and the consequences of the colonial era. These narratives spread by China in the developing world need to be seen as a part of China’s global outreach, which aims to secure Chinese interests. Europe needs to have an adequate response to this narrative building by China.

When it comes to the narrative about China within Europe, there has been a shift towards more assertive language, as illustrated by von der Leyen (2023). Nevertheless, the strong economic interdependence between China and the EU has also left its mark on the narrative. Sometimes European discussion related to China seems less critical than its narratives about the US, a close ally. To name one example from Germany: during the visit of Chancellor Olaf Scholz to Beijing, Jens Hildebrandt (2022), executive director of the German Chamber of Commerce in China, pointed out that trade with China, and European investments in China, have secured more than one million jobs in Germany. The continual announcement of foreign direct investment (FDI) by major German companies into China, especially in the car manufacturing and chemistry businesses, ensures, according to Hildebrandt, that these companies remain competitive on the global market.

In contrast, when it came to the US Inflation Reduction Act, the German Chamber of Commerce warned of negative consequences for European competitiveness and called for a joint European response (*DIHK* 2023) to protect European manufacturing industries.

The example of these two narratives demonstrates that the tone set by some key industries, and led by a handful of large companies, seems to be tougher and more direct with the US than with the increasingly protectionist China. This is remarkable, especially since FDI from the EU to China amounts to far less than from the EU to the US. In 2021 FDI from the EU to the US reached $3.19 trillion (Statista 2023), while European FDI to China plummeted to $0.05 trillion (Huld 2023).

Conclusions and recommendations for future engagement with China

While Ursula von der Leyen's (2023) speech on EU–China relations has revealed the use of more assertive language with regard to China, it remains to be seen how much of the announced de-risking will be translated into concrete action on different administrative levels. Based on the analysis conducted above, the following conclusions should be drawn and recommendations made.

First, the EU should fully implement the current or agreed-upon instruments, such as the FDI Screening Mechanism and the Anti-Coercion Instrument. This is low-hanging fruit that is more reachable than developing new strategies or instruments. To give an example: currently only 18 out of the 27 EU member states (European Commission 2022a, 9) have implemented a national FDI screening mechanism; the remainder are only in the process of doing so, despite the regulation having been adopted more than three years ago.

Second, when developing the newly announced Economic Security Strategy, the EU should focus on creating a common risk definition and assessment of the areas that the EU member states and other actors want to de-risk from. While a common understanding is crucial, it is equally important that common criteria for this assessment are developed hand in hand with industry representatives and with actors from civil society. When it comes to implementing de-risking together with European companies, the EU should strengthen the voices of those outside the handful big companies that are already heavily invested in China. To give an example of the political complexities: in November 2022, 12 senior executives from major German companies accompanied Chancellor Olaf Scholz to China. However, the head of the Federation of German Industries, which represents more than 100,000 mostly small and medium-sized companies, who had published a critical position paper on China in 2019, was not one of them (BDI 2019; Jensen 2022).

Third, the EU should clearly communicate and coordinate with third countries about its intentions and goals with regard to de-risking from China. A focus should be placed on cooperation with like-minded countries and on those that could profit from the de-risking process while offering possibilities for Europe's own green and digital transition. To counter the Chinese argument of neo-colonialism, the EU should build equal partnerships and clearly communicate its intentions and medium-term goals to external partners, finding mutually beneficial solutions. This does not mean forgetting the past. In order to back up its self-proclaimed goals with concrete means, in its financial programmes (e.g. its Global Europe: Neighbourhood, Development and International Cooperation Instrument) the EU should prioritise countries that can contribute to both the twin transition and de-risking from the Chinese market. The EU does not have to be equally active everywhere.

The EU should take both a bilateral and a multilateral approach to this prioritisation. In terms of the bilateral approach, the EU should fully utilise and possibly increase the number of its Trade and Technology Councils, which it currently operates with India and the US. Moreover, the EU should consult countries with whom it has negotiated green and/or digital partnership agreements. To give an example, in 2020 Japan launched a 'Program for Strengthening Overseas Supply Chains', which can be seen as a part of Japan's strategy to reduce overreliance on China by shifting supply chains to South-East Asia (Japan External Trade Organization 2023; Watanabe 2022). The EU could build on this example. The Union should look into how existing financial streams, such as the Global Gateway, could encourage this kind of 'friend-shoring'. Equally, the EU should utilise networks such as the G7 Coordination Platform on Economic Coercion, announced during the G7 summit in Hiroshima, to plan common programmes and projects with like-minded partners in third countries.

Fourth, the EU should further develop its instruments and trade agreements to match its political aims regarding de-risking and the twin transition. The Global Gateway strategy and the Team Europe approach to external action are a good start, but these initiatives need to be filled with concrete and impactful projects and agreements, visible to the populations in both third countries and EU capitals, as well as in Brussels. With limited resources and often colliding national interests, this will not be an easy task.

Note

1. Mercosur is a South American trading bloc. Its full members are Argentina, Brazil, Paraguay and Uruguay. Venezuela is a full member but its membership has been suspended since 1 December 2016.

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