EU-CHINA RELATIONS

SHAPING THE WAY FORWARD

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KEY MESSAGES

1 China is a crucial market for European companies. As the world's second-largest economy and the EU's second-largest trading partner, fostering a mutually beneficial relationship should remain a key objective for the EU and China. However, the increasing risks and challenges of doing business in and with China cannot be ignored.

2 The EU's "de-risking" strategy should focus on building resilience, through market diversification, reduction of vulnerabilities and risk management, particularly in strategic sectors like critical raw materials. A balanced approach across the EU's economic security strategy's three pillars—'promote,' 'protect,' and 'partner'—is crucial to ensure competitiveness. The EU should remain open, avoid protectionism and pursue an ambitious, proactive trade agenda.

3 The EU should defend its interests by using the strengthened trade policy toolbox to address market distortions and safeguard competitiveness of its industry. The EU should ensure its actions are balanced, WTO-compliant, and applied judiciously after thorough investigations. Maintaining a constructive dialogue with China is crucial to avoid escalating trade tensions.

4 The EU should act in unison. Only a strong and united Europe can muster the economic and political leverage needed to effectively engage and compete with China. The pursuit of Member States' individual interests should not undermine the collective EU interest in relation to China.

5 The EU should adopt a strategic, long-term approach to its relations with China, moving beyond reactive, short-term responses. Lacking this, other actors will dictate the direction of the geopolitical environment and of Europe's approach. This comprehensive and long-term vision should clearly define what Europe wants from China, and the business community should be involved in its shaping.

6 The EU should continue to engage with China, as an important partner in addressing global challenges.Key areas for cooperation include climate change, reforming the WTO and standardization, alongside collaboration in healthcare, all of which require mutual political willingness and commitment.

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Navigating Challenges and Charting a Path for the Future

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The landscape of EU-China relations has undergone significant changes in recent years and has led to careful reflections in the EU about how to move the relationship forward.

China is and will remain a crucial market for European companies in various ways, including as a significant market for selling European products, an important destination for investments and a key source of essential inputs. Moreover, China will continue to be a key partner to tackle global challenges, and the EU should continue to engage with China in several areas.

While fostering a mutually beneficial relationship between China and the EU should remain a priority, the increasing risks and challenges of doing business in and with China cannot be ignored. Companies now need to navigate a challenging geopolitical context, growing imbalances and lack of reciprocity in the Chinese market, while confronted with a growing politization of the business environment in China, where national security and self-reliance are prioritised over economics. Simultaneously, domestic demand in China remains sluggish, while market distortions and overcapacities have developed in several sectors, resulting in significant pushback from the EU and other economies.

This paper aims to take stock of the evolving relationship, highlight the increasing challenges and risks and propose a path forward. Central to this approach is the EU's "de-risking strategy", which emphasizes reducing vulnerabilities and safeguarding competitiveness, but should also enhance diversification through critical trade relations. To navigate the complex relationship with China, and be able to defend its interests, the EU must act in unison.

01 THE INCREASING CHALLENGES

1.1 CHALLENGING GEOPOLITICAL CONTEXT

The global geopolitical context is undergoing significant transformations, driven by rising conflicts, evolving security concerns, shifting alliances and emerging economic powers. This outlook has also had an impact on EU-China relations, which have further deteriorated in recent years.

A major point of contention is China's controversial stance on **Russia's war of aggression in Ukraine** and the growing bilateral trade between Russia and China. According to official Chinese data, trade between China and Russia has risen to a record high of $240 billion in 2023 up more than 64% since 2021[1].

Many analysts argue that trade with China is significantly bolstering Russia's economy, serving as a key lifeline for Russian energy exports following Western sanctions, with China increasing its imports of crude oil, coal, LNG, and pipeline gas since the start of the war. China has become the largest supplier of not only commercial goods but also an increasing number of dual-use components restricted by Western export controls, including items that Russia is unable to produce domestically such as microelectronics, machine tools, sensors and telecommunications equipment [2].

In addition to its relationship with Russia, **rising tensions in the Asia-Pacific region** pose further risks to European businesses. China has increased its activities around the Taiwan Strait and expressed its goal of 'national unification,' without ruling out the use of force. It has also become more assertive in the South China Sea, building military installations on disputed islands.

Moreover, geopolitical tensions are significantly fuelled by the ongoing rivalry between **the United States and China**, marked by escalating trade disputes and strategic confrontations. This rivalry is especially acute in strategic technologies and dual use items, such as semiconductors. AI, 5G, quantum computing, green energy and biotechnology are also critical technologies at the centre of economic and geopolitical competition. In the last two years we have seen growing action from the US to limit access for Chinese companies to these technologies and dual use goods. Measures include additional export controls, increased limitation of inflow and outflow of investments and reducing the use of Chinese materials in different products.

Moreover, tax incentives and investment stimulus packages in the U.S., such as the Inflation Reduction Act and the CHIPS Act, are designed to build resilience in U.S.-led supply chains and reduce exposure and dependencies from China. The U.S. is also increasing pressure on its allies, particularly the EU, to adopt similar actions.

1.2 GROWING IMBALANCES AND LACK OF RECIPROCITY

In the last decade, bilateral trade and investment flows between the EU and China have almost doubled, with total imports and exports

[1] http://english.customs.gov.cn/Statics/e1351568-5e17-4534-affd-c369e3506613.html#

[2] https://carnegieendowment.org/russia-eurasia/politika/2024/05/behind-the-scenes-chinas-increasing-role-in-russias-defense-industry?lang=en

reaching EUR 739 billion in 2023[3]. But our trade deficit has also worsened reaching EUR 400 billion in 2022. Although the EU's official statistics office Eurostat indicated that the deficit has slid to EUR 291 billion in 2023[4], certain analysts have attributed this primarily to a cyclical decline in European demand.[5] In addition, certain data indicates that despite this decrease in value, the exports from China to the EU in volume have actually increased. This anomaly may be explained by deflation and a depreciating Chinese currency.[6] In 2023, China was the third largest partner for EU exports of goods (8.8%) and the largest partner for EU imports of goods (20.5%).

The longstanding challenges of doing business in China-**market access and regulatory barriers-**, raised by the European business community for many years, remain largely unchanged and have even worsened in some areas, further hindering business opportunities for European companies. While there exists a wide variety of barriers in the Chinese market, European businesses highlight ambiguous rules and regulations as well as China's unpredictable legislative environment as their primary regulatory challenge[7]. The ongoing lack of resolution for these longstanding business challenges has further diminished the proportion of businesses that are optimistic about improvements in China's regulatory environment.

Additionally, a major issue is the significant **market distortions, competitive imbalances, and problematic overcapacities** resulting from large-scale government support in China. These developments, along with a protected domestic market, enable Chinese companies to achieve competitive scale globally, including by leveraging the advantages of the Chinese market.[8] Most concerns about excess capacity are primarily focused on clean technology sectors, including electric vehicles, solar modules, and wind turbines, which have experienced supply-demand imbalances in China for years, as well as input materials such as chemistry and steel. However, since 2021, there have been signs of rapid production expansion across numerous sectors, as Beijing has aimed to stimulate growth with supply-side policies during and after the pandemic. This situation highlights a systemic problem that extends beyond specific sectors[9] . The EU must address this challenge, but always based on substantiated evidence to avoid being perceived as denying access to Chinese companies for protectionist reasons.

Supply-side policies and industrial policies have been implemented in China for many years and they have been well documented[10]. Although several of its trade partners have directly raised concerns about these policies with China, it is worrying that China appears unlikely to change course anytime soon. For example, this year's Two Sessions—the National People's Congress (NPC) and the National Committee of the Chinese People's Political Consultative Conference (CPPCC)—placed a new emphasis on these measures. New Premier Li Qiang delivered his first "Work Report", which puts the focus on "new productive forces". It looks like China will continue to intensify its focus on basic and advanced manufacturing, while

[3] https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china_en#:~:text=China%20is%20the%20EU%27s%20second,and%20the%20biggest%20for%20imports

[4] EU trade in goods with China: Less deficit in 2023 - Eurostat (europa.eu)

[5] https://www.euractiv.com/section/economy-jobs/news/eu-china-trade-slips-as-beijing-de-risks-from-the-west/

[6] Position Paper (europeanchamber.com.cn) p.160

[7] https://www.europeanchamber.com.cn/en/press-releases/3560/european_chamber_calls_for_urgent_action_to_restore_business_confidence

[8] The 4 Key Strengths of China's Economy — and What They Mean for Multinational Companies (hbr.org)

[9] https://rhg.com/research/overcapacity-at-the-gate/

[10] https://policy.trade.ec.europa.eu/news/commission-updates-report-state-induced-distortions-chinas-economy-2024-04-10_en
https://www.bruegel.org/sites/default/files/2024-05/WP%2011%202024_4.pdf

demand-oriented stimulus measures appear to be less prioritized.

Even more worryingly, market restrictions, globally competitive scale from the Chinese home market and the overcapacity issue will seemingly continue in the coming years. For example, according to the latest Business Confidence Survey of the EU Chamber of Commerce in China, overcapacity has emerged as a more significant issue over the last year. Overall, 36% of respondents observed overcapacity in their respective industry in 2023, and another 10% expect to see it in the near future[11].

1.3 CHINA PRIORITISES NATIONAL SECURITY AND SELF-RELIANCE OVER ECONOMICS

As part of an increasing prioritisation of national security over market-oriented economic policy, Xi Jinping's China has pursued a national strategy of developing its competitiveness in a range of strategic technologies and reducing dependencies on foreign suppliers[12].

Under the "Made in China 2025" industrial strategy unveiled in 2015, the country has aimed to leverage government subsidies and other instruments such as low-cost raw materials, inputs, land and financial instruments to shift China's global domination of low skilled labour-intensive manufacturing towards high tech manufacturing sectors including electric vehicles, semiconductors, railway equipment and next-generation information technology and telecommunications, such as 5G. The policy explicitly called for a reduction in reliance on foreign technology by increasing the domestic market share of basic core components and important basic materials to 70 per cent by 2025[13] including 75% of its domestic market for mobile communications system equipment supplied.

Strategically important sectors to China's push for technological self-sufficiency receive preferential access to financing and public procurement, benefiting state-owned enterprises and selected 'Little Giants' (SMEs), to the detriment of private firms and foreign companies[14]. Moreover, trading partners have accused China of compelling foreign companies to transfer technology to local firms through joint ventures and other legal requirements[15]. While the joint venture obligation in the automotive industry was lifted in 2019, there is still a risk of forced technology transfer in other sectors. This technology allows local firms in sectors like high-speed rail and telecommunications to develop competitiveness and economies of scale. Once acquired, foreign competitors are subsequently restricted from entering the market on an equal footing[16].

The development of these Chinese firms has intensified the competition in China, with a significant share of European firms reporting losing market share to domestic competitors, and many declaring that they expect these competitive pressures to only increase with time[17]. China's policies impact the activities of European firms not only in China but also in third markets. Indeed, the combination of subsidies and the large scale of a protected home market to grow allows these national champions -many of them state owned enterprises- to enter foreign markets with highly competitive prices and capture significant market share to the detriment of European firms. As China's industrial strategy moves its exports up the value chain towards high-end products such as electrical machinery, the competition between European and Chinese firms for consumers in developing and emerging economies has

[11] https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

[12] https://merics.org/en/4-beijing-advances-technological-self-reliance-all-means

[13] https://www.reconnect-china.ugent.be/2024/01/12/reconnect-policy-brief-7-xi-curity-how-economic-security-ideas-shape-chinas-economic-strategies/

[14] https://www.europeanchamber.com.cn/en/press-releases/3560/european_chamber_calls_for_urgent_action_to_restore_business_confidence

[15] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3436484

[16] Home advantage: How China's protected market threatens Europe's economic power | ECFR

[17] https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

increased substantially[18]. The EU's use of trade defence instruments to level the playing field can help to protect EU industries' activities in the single market but will not solve the problem of their competitiveness in third countries. Moreover, this reinforces the need for more EU Free Trade Agreements so that European businesses can access new markets in more competitive conditions.

Since the deterioration of US-China relations, China has intensified its **"dual circulation" strategy** to support China's growth, shore up the domestic market and further reduce dependence on the West. This essentially involves insulating the domestic market from the rest of the world by removing bottlenecks in natural resources or technology, thereby enabling vertical integration of production and achieving self-reliance, supported by China's vast domestic market. A relevant consequence for the world, though, is that China will no longer need to import high-end inputs, with obvious negative consequences for major exporter countries of technology[19].

Behind a national security justification, China's export restrictions on critical minerals such as gallium, germanium and graphite also aim to foster domestic supply chains in downstream sectors (e.g. electronics, EVs).

1.4 GROWING POLITIZATION OF THE BUSINESS ENVIRONMENT IN CHINA

European firms operating in China are also concerned by a highly politicised environment in which policies and regulations aimed at reaching objectives set by the central government increasingly create market access barriers and challenges for the operations of foreign businesses.

The activities of foreign investors have been challenged by the introduction of laws and regulations aimed at protecting national security, whose ambiguous definitions and absence of clear provisions create an environment of uncertainty for firms.

For example, companies face difficulties ensuring they are complying with China's general requirements for cross-border data flows as the Data Security Law does not clearly define what constitutes "important data"[20], a category of data whose transfer, among several other scenarios, requires obtaining clearance from the Cyberspace Administration (CAC).

More recently, an amendment of China's anti-espionage law that expands the definition of espionage to include the purchase of documents and data related to the broad notion of "the national security and interest"[21], has sparked fears over the extent to which regular business activities such as market research could open firms to investigation and prosecution by authorities. The legal ambiguity in these regulations increases the perception of political risk for businesses operating in China, potentially leading some to reconsider planned investments.

At the same time, European firms active in the Chinese market are facing increased pressure from the implementation of new European legislation that requires them to investigate their supply chains for environmental and human rights abuses. The EU's Corporate Sustainability Due Diligence Directive (CSDDD) establishes a duty for companies based in the EU to identify and address potential violations of human rights and adverse environmental impacts in the operations of their company and its partners across their entire value chains. In addition, the Corporate Sustainability Reporting Directive (CSRD) strengthens the rules requiring companies to submit detailed reports outlining the sustainability of their activities.

[18] https://www.bruegel.org/working-paper/european-and-chinese-trade-competition-third-markets-case-latin-america

[19] https://www.prcleader.org/post/what-is-behind-china-s-dual-circulation-strategy

[20] https://jamestown.org/program/chinas-important-data-regime-challenges-global-norms/

[21] https://www.engage.hoganlovells.com/knowledgeservices/insights-and-analysis/china-amends-the-anti-espionage-law

Along with the difficulty of collecting some of this information from upstream suppliers in China, companies may find themselves struggling to conform to conflicting jurisdictions, trying to follow new European reporting obligations while remaining compliant with the aforementioned Chinese legal system's restrictions on the disclosure of information deemed sensitive. Similarly, the EU's Forced Labour regulation empowers the European Commission to investigate goods produced outside the EU that are assessed as at risk of being made with forced labour and decide to prohibit economic operators from placing them into the Union market if they are found to have been made with forced labour[22]. Faced with the difficulty of verifying the entirety of their supply chains and the risks associated with an investigation, these laws may compel companies to divest altogether from regions and sectors considered as highly likely to include forced labour.

1.5 THE CHINESE ECONOMY IS SLOWING DOWN

According to most analysts the Chinese economy is slowing down, and its decline could continue over the next years. Of the risks identified, China's economic slowdown has emerged as a central concern for European companies operating in China.[23]

The IMF has recently predicted[24] the decline in China's economic growth to persist over the next four years, stemming from a combination of factors including a rapidly aging population, rising unemployment, and a property crisis. China's economic growth is projected to decrease to 4.6% this year, down from the 5.2% growth recorded in 2023, and is forecasted to further decline to 3.4% by 2028.

The property market, which historically represented approximately a quarter of China's GDP, has become a significant area of concern for the Chinese economy. The liquidation of China Evergrande, a major Chinese property giant has exacerbated the challenges facing the sector. Without a comprehensive restructuring policy package addressing the challenges in the troubled property sector, there is a risk that real estate investment could decline beyond initial projections and persist for an extended period. This situation could have adverse effects on domestic growth as well as on trading partners.

In addition, inbound FDI in China has dropped 28.2% in the first five months of 2024 from the same period last year to 412.51 billion yuan ($56.8 billion), according to data released by the Chinese Ministry of Commerce on June 21. The figure was worse than the 27.9% drop in April and extended a streak since June 2023[25].

In response to a sharp decline in FDI that has brought inbound investment down to its lowest level in 30 years[26], the PRC government has in fact signalled efforts intended to increase its attractiveness to foreign capital. In March 2024, the State Council presented a 24 point Action Plan that included measures such as reducing the negative list for foreign investment access, expanding the catalogue of industries encouraged for foreign investment, calls to end discriminatory treatment of foreign companies in areas like subsidy reception and government procurement, and other measures designed to facilitate collaboration between Chinese and foreign firms, such as improving

[22] https://www.consilium.europa.eu/en/policies/forced-labour-products/#:~:text=5%20March%202024)-,Investigations,territory%20of%20a%20member%20state

[23] Position Paper (europeanchamber.com.cn) p.4

[24] World Economic Outlook Update, January 2024: Moderating Inflation and Steady Growth Open Path to Soft Landing (imf.org)

[25] https://www.bloomberg.com/news/articles/2024-06-21/china-foreign-direct-investment-falls-for-12-straight-months

[26] https://asia.nikkei.com/Economy/Foreign-direct-investment-in-China-falls-to-30-year-low#:~:text=China's%20foreign%20direct%20investment%20totaled,down%20about%2080%25%20from%202022.

the visa conditions for foreign workers and the convenience of cross-border data flows[27].

This follows from the State Council's previously announced set of opinions in the summer of 2023[28], which also included calls to support foreign companies' research & development, participation in standard-setting and the protection of their intellectual property rights. The announcement of these measures is positive and welcome, but it remains to be seen how they will be effectively implemented and to what extent they can reverse the declining confidence of foreign business in the Chinese market.

1.6 CHINA CONTINUES TO BE A VERY IMPORTANT MARKET FOR EUROPEAN COMPANIES

Despite the challenges outlined above, China continues to be a very important market for the EU. As the second largest economy in the world and the EU's second largest trading partner for goods, cultivating a mutually beneficial relationship between the EU and China remains an important objective for both economies.

China is the third largest non-EU export market for EU companies, with exports from member states increasing more than seven-fold since the early 2000s in parallel with the growth of the Chinese middle class as a consumer market for goods[29].

The country remains a key market for European motor cars and vehicles, representing close to EUR 20 billion in exports in 2023, as well as for other machinery and medicines[30].

China remains a key procurement market. China also represents an important export market for several member states in agri-food trade, and specialty products like wines and spirits and cosmetics[31].

The EU also benefits from the import of Chinese products. The supply of raw materials and cheaper intermediate goods is an asset for the competitiveness of EU industries. Meanwhile, the price of many consumer goods such as electronics or textiles has been lowered due to Chinese imports[3233].

Despite the economic slowdown, the size and continued growth of the Chinese market will continue to make it an attractive destination for European exports and investments. In addition, China presents a vibrant R&D ecosystem marked by a variety of potential partners including many start-ups and researchers, offering European companies an attractive hub for innovation in their products and operations[34].

27 https://www.china-briefing.com/news/foreign-capital-in-china-action-plan-attract-fdi/

28 https://www.gov.cn/zhengce/content/202308/content_6898048.htm

29 https://www.statista.com/statistics/1419027/eu-china-relations-exports-to-china/

30 https://ec.europa.eu/eurostat/statistics-explained/index.php?title=China-EU_-_international_trade_in_goods_statistics#EU-China_most_traded_goods

31 https://www.china-briefing.com/news/eu-china-relations-trade-investment-and-recent-developments/

32 https://www.bruegel.org/working-paper/state-china-european-union-economic-relations

33 https://www.cpb.nl/en/economic-interwovenness-with-china-through-trade-two-sides-of-the-same-coin

34 https://merics.org/en/report/chinas-innovation-ecosystem-right-many-not-all

How to move forward

02 THE EU'S NEW "DE-RISKING" PARADIGM

2.1 IT IS ALL ABOUT DE-RISKING NOT DECOUPLING

The term "de-risking" reflects the EU's growing focus on economic security in its relationship with Beijing. 'De-risking,' is about reducing vulnerabilities and mitigating or managing risks and dependencies, within the existing framework of economic relations. De-risking is not about seeking to minimise trade relations or decouple supply chains entirely.

While China will remain a crucial market for European companies, whether for sourcing raw materials or components, for investing or for selling their products, it is crucial to reduce exposure in areas where China holds a dominant position, such as critical minerals. Prioritizing the diversification of supply sources in strategic sectors will help mitigate objective risks associated with excessive dependencies. The decision by the Chinese government to apply export controls to germanium, gallium, graphite and more recently antimony is an example of how excessive dependencies can lead to vulnerabilities.

The Communication on a European economic security strategy and its associated package of initiatives could serve as a guiding tool for the EU to de-risk and diversify away from China, where warranted. In this regard, it is crucial that the EU conducts a **well-calibrated and comprehensive assessment of the risks** it is exposed to, as identified in the context of the Strategy. Addressing dependencies, risks and supply chain vulnerabilities will require careful consideration, as the EU should avoid both the risk of not doing enough and the threat of doing too much, thereby turning towards protectionism. This assessment is a critical first step in the process and reference should be drawn to the position paper that BusinessEurope has published at the end of May 2024[35].

We support the three-pillar structure of the EU's economic security strategy, recognizing the equal importance of the 'promote,' 'protect,' and 'partner' pillars. However, the 'protect' component currently receives disproportionate attention and is more advanced. The business community is concerned that without proper balance, instruments supporting economic security might adversely affect competitiveness. To mitigate this, it **is essential to equally advance initiatives under the 'promote' and 'partner' pillars**, which can enhance economic security and competitiveness by achieving a level playing field and encouraging diversification.

2.2 CONDITIONS SHOULD BE CREATED FOR COMPANIES TO BE ABLE TO "DE-RISK"

Strengthening the competitiveness of the EU

For the EU industry to continue to compete successfully with China and address its growing competitiveness gap, Europe needs to do a reboot of EU policies and start delivering the New European Competitiveness Deal. As recognised in the Draghi and Letta Reports and included in the political guidelines for the next European Commission, "prosperity and competitiveness" must be the top priority

[35] https://www.businesseurope.eu/publications/business-views-european-economic-security-strategy-businesseurope-position-paper

for Europe. The following actions are key to maintain the attractiveness of Europe as an investment location:

- **Reduce the regulatory burden and support a well-integrated European Single Market**: European companies are confronted with increasing reporting requirements and administrative burden stemming from many new regulations. This situation is strongly impacting the EU's attractiveness for investors. The Single Market is a crucial asset for European industry when competing globally. Remaining barriers to free movement hinder growth and their full removal is essential to further deepen and modernize our home market, giving more freedom for developing economic activities and improving productivity.
- **An ambitious industrial strategy for a resilient future:** To pave the way to a resilient future, improve our competitiveness and decarbonise without deindustrialising, the European Union must complement the Green Deal with a Competitiveness Deal, including a structural solution for the energy cost differential between the EU and our major competitors. It has to ensure that companies have the means to invest in the deep transformation required and attract more foreign direct investment by setting up a framework that will unlock the public and private investment resources needed to ensure the success of the twin transition and further improve EU interconnections and infrastructures.

In addition, the EU should implement the necessary elements for ensuring **open strategic autonomy**, including as outlined in the following points.

Diversifying and partnering with others is key

Partnering with third countries is crucial for EU companies to access alternative markets for sourcing raw materials and components, exporting their products, and finding new investment locations. Diversification is essential to mitigate risks and reduce Europe's dependencies on any single or dominant source.

Promoting European capacity and protecting vital security interests must be balanced with a strong commitment to openness and international cooperation. The rise in trade restricting measures could potentially weaken the EU's economic influence and its relationships with trading partners. In today's geopolitical landscape, where national security risks are heightened worldwide, it is important for the EU and its partners to identify common threats and address them through international cooperation whenever possible.

Moreover, an ambitious offensive trade agenda that strengthens relations and alignment with existing trade partners and builds new partnerships around the world would support the EU's positioning vis-à-vis China. **Trade agreements are indispensable tools for diversifying import and export** markets, guaranteeing legal certainty, and fostering economic opportunities. They contribute to the EU's economic resilience and security while ensuring a level playing field among EU companies and third-country businesses. It is imperative for the EU to swiftly conclude on-going trade negotiations and adopt a proactive trade policy in the upcoming legislative cycle. This policy should secure full market access and deliver tangible benefits for both the EU and its partners. Trade agreements should not be overloaded with policy objectives better pursued through other instruments. Pragmatic approaches that consider the interests of the EU and the varying geopolitical and economic realities of its partner countries are essential.

Diversifying sources of raw materials and rapidly implementing the EU Critical Raw Materials Act should be a top priority for the EU. In an optimistic scenario, the EU will be able to source only 10% of raw materials domestically by 2030[36]. China dominates global critical mineral supply chains, accounting for approximately 60% of world-wide production and 85% of processing

[36] https://ec.europa.eu/commission/presscorner/detail/en/ip_23_1661

capacity[37]. It is encouraging that the first pillar of the EU Raw Materials Strategy commits to Raw Materials Diplomacy, engaging with non-EU countries through strategic partnerships and policy dialogues.

The EU has already established partnerships with several countries, and it should continue to strengthen these alliances while seeking new ones. With like-minded partners, the EU should push to enhance global free trade in critical minerals and strengthen its Global Gateway initiative for the security of global supply chains, particularly with Africa, Latin America and Southeast Asia.

Digital Partnership Agreements, such as those signed between the EU and Japan, South Korea, and Canada, could significantly enhance the partner pillar of the European economic security strategy. Expanding and deepening these agreements with additional partner countries should be a priority. In addition, discussions within the EU-U.S. Trade and Technology Council, including issues like 6G and trusted connectivity in third countries, highlight the importance of cooperation with the U.S. on these matters.

Improving the EU's offer towards third country partners

Many third-country partners have criticized the EU for certain legislation arising from the EU Green Deal, such as the EU Deforestation Regulation, citing inadequate consultation with these partners. This, among other factors, is resulting in a loss of image and influence of the EU in many middle- and low-income countries, although the EU is still the largest provider of official development assistance.

We should enhance our value proposition to our trading partners, particularly developing countries and middle-income countries by tailoring our approach to their needs.

This includes combining trade and investment agreements with establishing partnerships for critical raw materials, including international partnerships such as the Minerals Security Partnership, utilizing trusted digital technologies, and offering capacity building and development incentives. It is essential that developing countries are actively involved in global discussions that affect them. The EU must seek mutually beneficial partnerships with emerging markets and developing economies, leveraging initiatives like the Global Gateway to enhance the EU's attractiveness and position as a reliable partner.

In parallel, the evolving landscape of European legislation, including the Corporate Sustainability Due Diligence Directive (CSDDD) and the EU Forced Labour Products Ban Regulation, will impose new requirements on companies operating within the EU. These companies will need to report detailed information about their supply chains, which will present significant challenges.

These challenges include missing data, difficulties in tracing information, particularly in long and complex supply chains, and ensuring compliance with varying regulations across different regions.

The EU must actively engage with third countries to assist their companies in complying with these regulations, to avoid accusations of protectionism and the lowering of its attractiveness as a trading partner. Proactive dialogues through international institutions such as the WTO and OECD are also important.

[37] https://www.gmfus.org/news/chinas-role-critical-mineral-supply-chains#:~:text=China%20dominates%20global%20critical%20mineral,process%2C%20and%20manufacture%20critical%20minerals

03 THE EU SHOULD DEFEND ITS INTERESTS

3.1 THE EU SHOULD CONTINUE TO USE THE TOOLBOX AT ITS DISPOSAL

As explained previously, the strong focus on supply-side policies in China in the past years has led to significant market distortions and overcapacities. This has created an uneven playing field, causing various industries in Europe to suffer from unfair trade practices, loss of market share and a weakened competitive position.

To address these challenges, **the EU should resort to the various instruments at its disposal** to safeguard the competitiveness of sectors that are crucial for the EU economy. Over the past few years, the EU has significantly strengthened its trade policy toolbox and should utilize both newer measures, such as the International Procurement Instrument (IPI) and the Foreign Subsidies Regulation, as well as the traditional trade defence tools, including anti-dumping and anti-subsidy measures.

All these measures should be **applied judiciously**, based on **thorough investigations and a case-by-case analysis, while fully adhering to WTO rules and always considering what is best for the EU's interest**. This balanced approach ensures that actions are justified and effective, minimizing the risk of escalation. When warranted, ex-officio investigations should be carried out by the European Commission, with the coordination and support of the concerned industry.

We encourage the European Commission to continue to **keep an open dialogue with China on these issues at all levels** including during political Summits and the High-Level Economic Dialogues. The aim should be to avoid escalating trade tensions whenever possible while firmly safeguarding the interests and values of the EU. The EU's approach should not be understood as protectionist but as an effort to level the playing field, address supply chain vulnerabilities, and maintain a viable industry in Europe, particularly in strategic sectors.

3.2 COOPERATION WITH ALLIES AND PARTNERS ON CHINA RELATED ISSUES

The EU should safeguard and project its interests and values through all possible avenues, leveraging its relationships with allies and other partners. This cooperative approach is essential, especially on issues with global or multilateral implications. Such issues include subsidies, economic security and decarbonization, where multilateral or plurilateral efforts can lead to more effective and sustainable outcomes.

To this end, cooperation with like-minded partners and allies is already underway in forums like the G7, where shared values and strategic interests tend to converge. This cooperation should be pursued while making sure to strictly safeguard the EU's and its Member States' interests. However, it is crucial for the EU to intensify its efforts to **enhance relations with other partners including the so-called "Global South"** countries. In an increasing multipolar world, characterized by rising unilateralism and great-power rivalry, engaging with these nations is crucial to prevent current global geopolitical tensions from escalating into a scenario of "the West versus the Rest". Moreover, these countries face similar challenges, and partnering with them will give the EU greater leverage to address these issues effectively. In order to effectively build these partnerships, projects under the Global Gateway are crucial to offering a credible alternative to China's Belt and Road Initiative (BRI) in meeting developing countries investment needs. A Whole-of-Government approach allowing coordination of various external financing instruments across agencies and programmes forms a crucial element for the Global Gateway to succeed, faced with the comparable support provided by the governments of global competitors.

Multilateralism remains the most favoured approach for managing global relations. But in the face of mounting challenges, the multilateral system and its structures are under strain. The WTO would be the favoured fora to discuss issues that affect the relationship of many countries with China. Yet, the WTO is in need of reform, ranging from the resolution of the blockage of the Appellate Body to new rules on the most pressing challenges of our time. These issues include for example proper disciplines on subsides and competitive neutrality as well as technology transfer, and violations of trade secrets.

When multilateral solutions are not possible, we support the creation of 'clubs of the willing' (e.g. on subsidies) and plurilateral agreements to advance specific issues and avoid stagnation. These "clubs" should be open to all countries that are willing to participate.

04 A STRONG AND UNITED EUROPE THAT ACTS STRATEGICALLY

4.1 THE EU SHOULD ACT IN UNISON

The challenges presented by China's economic and political system are too significant for any single Member State to address alone. **Only a strong and united Europe can muster the economic and political leverage** needed to effectively engage and compete with China. The EU will remain vulnerable to Beijing taking advantage of internal divergences as long as a united and coordinated European approach vis-à-vis China is missing. A first step has been taken by adopting the Anti-Coercion Instrument (ACI) to deter and respond to economic coercion, and thereby better defend its interests and those of its Member States on the global stage.

The EU is the world's largest single market, one of the largest traders of manufactured goods and services and one of the largest economies with an average GDP per capita of €37 620 in 2023 for its 448 million consumers[38]. To leverage this economic strength, the EU must translate it into greater political unity and assertiveness. Only a strong and united Europe can effectively promote its interests and values in the face of rising global powers like China and the increasing trend of protectionism.

European companies and EU Member States are currently facing a **collective action problem.** They would benefit from standing together to encourage China to implement necessary reforms. China leverages tools such as asymmetrical market openness, visa-free entry into China, and selective procurement to undermine this collective effort. The pursuit of Member States' individual interests should not undermine the **collective EU interest** in relation to China. It is therefore of critical importance for the ability of the EU to act in the face of foreign pressure on individual Member States that the European Council moves from unanimous decision making on foreign policy issues towards **qualified majority voting (QMV).**

Member States should invest in **knowledge sharing and capacity building on China** at EU and Member State level and set up an information-sharing mechanism. One of the drawbacks that undermines unity of action is a disparity in available expert information at different levels of policy and across Member States. A clear understanding of the opportunities and challenges in the relationship with China will help inform better decision-making at all levels.

4.2 THE EU SHOULD ACT STRATEGICALLY AND THINK LONG TERM

The EU has been guiding its relations with China through the lens of the "EU-China strategic outlook"[39] since its publication in April 2019. China has simultaneously been considered a partner for cooperation on major global issues, a technological and economic competitor as well as a systemic rival with its own set of values, distinct from the European democratic model.

[38] Eurostat - Key figures on Europe – 2024 edition, accesible here: https://ec.europa.eu/eurostat/documents/15216629/19559843/KS-EI-24-001-EN-N.pdf/4aa75d55-c529-414b-5dc2-e4be3df1b199?version=3.0&t=1722243547613

[39] European Commission, 'EU-China – A strategic outlook', JOIN(2019) 5 final, 12 March 2019

The Joint Communication assessed various dimensions of EU-China relations, highlighting both opportunities and challenges, and proposed 10 concrete actions. However, these actions were designed with a short to medium-term horizon, and most of them have either been implemented or are outdated.

Meanwhile, the EU has adapted its approach to China as the geopolitical landscape evolved and challenges intensified. In recent years, the EU's approach towards China has become more assertive e.g. using all the tools at its disposal as described in section 2.1 of this paper. However, this approach has largely been reactive and defensive rather than proactive. **The EU has primarily responded to China's actions, rather than taking bold, forward-thinking steps to influence future events in favour of Europe's interests.** While this reactive strategy may have short-term effectiveness, **it is less likely to be successful in the long term, as it allows other actors to dictate the direction of the geopolitical environment and of Europe's approach.**

The EU should develop a comprehensive vision for EU-China relations in the current global context, clearly defining what Europe wants from China, with the involvement of the business community. This vision will then allow the EU to formulate a consistent **long-term China strategy**. This strategy should, among other things, outline the objectives and goals, the strategic priorities, and a detailed road map for the future.

To achieve this, the EU should equip itself with the necessary resources, including the following:

- The EU and its Member States should establish a **strategic dialogue on China**, involving **EU Member States, EU institutions, and the business community**, with active support from academia and key stakeholders. This initiative would foster a comprehensive understanding of China's economic and political landscape, enabling a coordinated and effective approach. The dialogue would help align policies, share insights, and develop strategies that promote the EU's interests and values, enhancing the EU's capacity to navigate its complex relationship with China.
- Annual meetings should take place that facilitate greater information exchange between different levels of policymaking and parts of civil society that help underpin a **whole-of-government approach** at EU and Member State level. These could take the form of a high-level dialogue, with specific coordination or working groups that focus on particular issues. This strategic dialogue may also bolster European Commission resources with the information required from business in order to take greater enforcement action. This information is often lacking as companies fear that providing information may lead to retaliation from China.
- The **EU's research capacities on China should be increased** to support informed, intelligent and effective policymaking. While European studies on China have increased in recent years, resources should be enhanced to adequately and systematically analyse the economic, political and security implications of Chinese policies on the EU at regular intervals.
- EU companies, particularly SMEs, would benefit from increased information and guidance on identifying risk factors, including political and geopolitical, in the Chinese market. The Commission could pull knowledge and expertise across its services and share this information with companies directly as well as with Member States, who have closer ties with their national SMEs. Business associations would also play a crucial role in this effort.
- Due to the differences between industries and sectors, individual, granular strategies may have to be adopted for each of these sectors **rather than a 'one size fits all' approach**. This process should be facilitated by gathering contributions from the European business community, including from at-risk industries, to provide concrete recommendations on the desired outcome and the most effective means to get to that point.

- A key part of the China strategy should be to strengthen the competitiveness of the EU as outlined in section 2.2 of this paper. In this process, the EU should **seek to develop its competitive advantages and focus on enhancing these assets** in order to reinforce its resilience and increase its importance in global supply chains.
- A forward-looking strategy should also consider the Chinese investments that the EU will be receiving in the next years, in particular greenfield investments.[40]

Notwithstanding the fact that Foreign Direct Investment Screening mechanisms remain a national competence, further European coordination and integration is key to avoid single market fragmentation. **Apart from national security concerns, it is fundamental that these investments fully respect European rules and standards.**

[40] https://merics.org/en/report/dwindling-investments-become-more-concentrated-chinese-fdi-europe-2023-update

05 THE EU SHOULD CONTINUE TO ENGAGE WITH CHINA

Despite various challenges, significant opportunities for EU-China cooperation remain in critical areas. The EU should keep in mind that China, besides being a competitor and a systemic rival, remains a necessary partner in certain areas, particularly where multilateral solutions are needed. Although conditions for engagement and cooperation with China may not be ideal at the moment, our economies are strongly interdependent, and we face many common challenges requiring global solutions.

5.1 THE AREAS OF ENGAGEMENT

One of the most pressing issues is **climate change**. We count on China to take a leadership role and maintain its commitment to urgently decarbonize its economy. Real action from all major emitters is essential. Europe is making a substantial effort to decarbonize, but we cannot achieve this alone; China and other major partners need to follow suit. We praise the Chinese concept of "ecological civilisation" which has been highlighted during the Third Plenum in July 2024 and could be a good framework to achieve sustainable development. Cooperation with China on other **environmental and sustainability** issues should also be pursued.

Another important issue is the **reform of the WTO**. The WTO cannot remain permanently on life support. The EU should work with China, alongside other parties, to ensure the multilateral trading system is effective. Additionally, cooperation on standardization, including international standard-setting and the adoption of international standards, is crucial to facilitate trade and interoperability. Finally, healthcare and pandemic prevention are also important areas for cooperation.

Successful collaboration will always require political willingness and commitment from both sides.

5.2 COOPERATION ON IMPROVING MUTUAL INVESTMENT CONDITIONS

The negotiations with China on the Comprehensive Agreement on Investment (CAI), were finalised by late 2020. However, the CAI was never ratified due to the countersanctions imposed by Beijing on several MEPs (among other European citizens and institutions), in retaliation for the EU's own sanctions against four Chinese officials and one entity, for human rights abuses in Xinjiang.

BusinessEurope considers that the CAI was, at the time it was negotiated, a step forward as the agreement could have potentially addressed some of the trade and investment imbalances between the EU and China. Nevertheless, the suspension of the ratification process has made the CAI unable to come to light.

Given the significant shifts in the geopolitical landscape since the CAI was negotiated, it seems that restarting the ratification process is not a viable option, and reaching a comprehensive agreement – even an updated version of the CAI – appears rather unlikely. Nevertheless, BusinessEurope suggests engaging with China on targeted issues covered by the CAI, outside the framework of a comprehensive agreement.

RECOMMENDATIONS FOR COMPANIES

China will continue to play an important role for many European companies, in terms of revenues, supply chains, manufacturing, and research and development efforts. However, against the backdrop of growing challenges and risks, it is important for European companies, to assess and possibly recalibrate their strategies vis-à-vis China.

Most EU companies have already begun efforts to minimize such risks and will continue to explore additional strategies to avoid excessive dependencies and vulnerabilities, while enhancing resilience and security. While bigger companies may have these strategies in place, SMEs may not have the same level of awareness. Companies should consider the broad range of dependencies on China, including sourcing a majority of inputs, components, or raw materials from China, as well as relying significantly on China for revenues or R&D. Depending on issues such as the sector and business model of the companies, their strategies can vary. However, the following are some suggestions and issues that companies could look at when considering their overall strategy and exposure to China:

- Implement – if not already existing – an overall risk assessment for worldwide activities
- Regularly assess forecasts of economic growth in key markets
- Monitor key signposts for policy and geopolitical developments
- Review sourcing, manufacturing and IP exposure
- Identify and promote alternative markets
- Avoid exclusively relying on a single source
- Companies operating in critical technology areas as defined by the Economic Security Strategy should take specific measures to protect their subsidiaries in China from the risk of technology leakage[41].

[41] https://ec.europa.eu/commission/presscorner/detail/en/IP_24_363

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