



Building the strategic autonomy of Europe while global decoupling trends accelerate

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Abstract: What does it mean to build the strategic autonomy of Europe? It is neither a simple nor an easy endeavour. It will take effort to build consensus and more time to agree on a common framework and commit to it, and to make compromises on national objectives. It is all about European sovereignty. It is Europe's transformation from a giant economic power, into a geopolitical player in the global system. Against a background of accelerating global decoupling trends and great power competition, a drive for European strategic autonomy, acquires a particular significance. But what strategic autonomy will actually mean, what will actually change in terms of funding and organisation, is now less clear. Ultimately it will be about defence and security, enlargement, and deepening.

The discussion and re-orienting of strategic autonomy in Europe

The discussion on strategic autonomy cannot be but very timely in the current situation of dramatic geopolitical shifts. We may go back to look at how the debate has evolved between

the 27 member states in the recent past years and realise how the deep transformation of the international framework is affecting these debates. We are facing new challenges and others, that we may not be anticipating.

To start with the evolution of the debates on strategic autonomy between the 27 member states, what we see is that we're moving from what has been in the beginning a very fierce division on what was still considered a sort of midterm objective, towards which we could trend over time, to a much larger cohesion now, when strategic autonomy is considered as an urgent need. The war in Ukraine has provided a stress test for the European strategic autonomy, which calls for recognising current geopolitical challenges and anticipating future ones.

If we briefly look back at the initial debates, we remember that the expression of strategic autonomy was first used in 2013 in the conclusions of the European Council. The expression was coined in the field of security and defence. And this immediately raised some mistrust and suspicion in some member states, about what could be understood in terms of the relationship with NATO. It was all about the right balance between increasing the capabilities of European defence and the coordination with NATO.

But then there were a series of international factors that were reorienting the discussion on strategic autonomy. When we look back, the first thing is, of course, the two mandates of Xi Jinping in China, since he became the head of the communist party in 2012, which were characterised as an incentive for the Chinese economy to diverge from the path of the market economy and to focus on the development of state capitalism. This meant an increasing role of State-Owned Enterprises (SOEs) and the more extensive use of public subsidies, creating trade distortions with other trade partners, which were challenging for the Europeans. These developments had progressively forced the Europeans to consider China not only as a partner, but as a competitor, and in the end in 2019, as a systemic rival.

The second factor reorienting the discussion on strategic autonomy in Europe, was the presidency of Donald Trump in the United States. His aggressive unilateral tariff policy and the type of trade war that he had launched, forced the Europeans to adopt a more assertive position and response. In the end the Europeans responded coercively to the aggressive tariffs on steel and aluminium from the United States and thwarted the threat of new tariffs on the automotive sector. Today, we have the litmus test from the war in Ukraine. The challenge for the Europeans is to address the energy crisis and high inflation that have been exacerbated by the war. The EU needs in addition, to address the distortion of competition caused by the US Inflation Reduction Act, aiming at accelerating the green transition of the US economy via a very ambitious programme of subsidies et tax credits linked to local content provisions.

In sum, we have moved from a decade of intense domestic discussions on the trade-off between trying to preserve the attractiveness of the single market, supporting multilateralism, and relying on NATO protection on the one hand, to equipping the EU with

new tools to defend its interests more autonomously, both on the economic and the defence levels.

We had for a couple of years some internal division, notably between the Scandinavian countries and the rest, on the risk of moving the EU towards more protectionism, which could have an impact on the attractiveness of the European economy. On the other side we had France, which was a very loud defender of strategic autonomy. And we remember that at the beginning of the French Presidency of the Council of the EU, when Emmanuel Macron presented the agenda, he put strategic autonomy very high on that agenda.

And we remember last year, in March, following the outbreak of the war in Ukraine, when Mark Rutte, the Dutch Prime Minister visited Paris, who is well known for his very liberal approach, he finally concluded that strategic autonomy was really a priority and that we had to speed it up. On this agenda there has been really, a U-turn in European thinking around the start of the war in Ukraine.

The risks of economic interdependence

If we have a look at the transformation of the global framework, the assessment that is widely shared, is that we have an economic interdependence, which has developed very quickly with the acceleration of globalization in the 1990s, which has now turned into an economic security challenge, with economic interdependence increasingly used for economic coercion. This is well known as the weaponization of economic interdependence.

With the COVID pandemic we have already been exposed to the risk related to strategic dependencies on the foreign supply of imports into the EU, and the problem of the concentration of production in some countries, or even in some firms. We have also been exposed to the risk related to export restrictions.

In addition, we have been witnessing the attitude of China, exerting economic coercion, not only on Australia, but also on Canada, and more recently on Lithuania. China was applying sanctions not only on exports of Lithuanian goods but on any European goods including some intermediate components coming from Lithuania. So, this has raised more awareness of the risk of export restrictions and different modes of economic coercion.

In addition to that, we have of course, the response of China to the war in Ukraine. I don't need to expand very much my comments on that, suffice it to say, that China has signed this unlimited partnership with Russia, didn't denounce the aggression in Ukraine, is supporting the Russian economy by buying additional quantities of oil and gas than before the outbreak of the war, and exporting some goods within the red lines of the sanctions applied by the Western Allies. For the moment, we don't have any proof of China breaching those sanctions, but the maximum support you can bring to Russia around those sanctions, is on the table. And, of course, an additional threat has risen over the status quo of the one-China policy concerning Taiwan.

Decoupling

What all that purports to, is that the decoupling from China is obviously accelerating. We have moved from what was still a selective decoupling and the unilateral decoupling of the US from China, to reciprocal decoupling from China, and now to a more encompassing decoupling that is accelerating.

But it is still a selective decoupling, because when we see the evolution of trade flows between the US and China, the Chinese exports to the US have continued to increase in 2021. So, decoupling doesn't concern all the goods that are going to the US. It is a selective decoupling because it is for the moment focused on the technology and the financial sectors. Within the technology sector the decoupling is extending and broadening, and it has turned more aggressive, if we also look at all the initiatives that have been taken from the Chinese side.

We know that the US has its own entity list for export restrictions, on which foreign firms and notably Chinese firms are progressively added. US companies are required to seek license if they want to export certain technologies to those firms in the list. China on the other hand has reciprocated in kind, having adopted its own entity list concerning their foreign firms on which export restrictions are applied.

At the same time, the US has started to clean its strategic infrastructure from Chinese technologies. Similarly, China has also called to clean its strategic infrastructure not only from the US, but also from other foreign technologies. And we have on the US side, the very well-known extraterritorial instrument, and China has adopted in 2021, its own in extra-territorial instruments.

We see very well that the two blocks, the US and China, are organizing and preparing themselves for an accelerated decoupling. And in addition to that, under the leadership of Xi Jinping, China has been focusing on the principle of more self-sufficiency for its economy, more leadership in the technological sector, substituting foreign technologies with domestic technologies, and looking to rely more on its domestic consumption.

In terms of its economy, China is becoming more unstable, which provides added incentives for foreign companies to invest less in the Chinese economy and to make a closer assessment of the risks they will be exposing themselves to by investing in China.

All that means that for foreign firms and specifically for European firms, the international framework is much more complex now, and they have to closely assess what is their interests, their strategies and market positioning.

At the moment the need to work more closely with the US in supporting Ukraine, which is pushing Europe for closer transatlantic cooperation. We obviously need the support of the

US for security reasons, and for its support to Ukraine. We increasingly also need the support of the US for energy supply. We remain engaged in trade and technological cooperation, on many issues of common concern.

But on the other side, we are facing China, which is increasingly isolating itself from the Western bloc, and has the ambition to lead what they call the global house, and to be the leader of the emerging economies in the promotion of a new global order, which would be much more inclusive for emerging economies. This tends to solidify, not only the expression but also the reality of the 'West versus the Rest'. And the question for Europeans, is this really, the scenario that we want to favor?

Addressing the challenges

While Europeans need to think about the ways to address those challenges, we have to keep in mind some specificities of the European economy, which are also impacting our debate on strategic autonomy. First of all, Europeans continue to have some very regional supply chains, when the Chinese and Americans tend to have more global supply chains. I mean, the tendency during the past years had been to have more land bound supply chains. There has been also a very steady trend for the substitution of the production of intermediate goods in the European markets, by Chinese components.

Between 2011 and 2021 the trade ties between the EU and China developed incredibly. EU imports from China increased by 86% in the period and exports of the EU to China increased by 76%. The EU became the largest trade partner of China.

China intends to limit its imports from the EU and from the US and to rely more on its domestic production and has been progressively replacing imported components from Europe with other components domestically produced. This has led more recently to an increasing unbalanced trade relationship with China.

EU exports to China have slowed. When we look at the reports of the EU Chamber of Commerce, we see that China in 2021, was selling three times more to the EU in value terms, than the EU to China, which is a very, stark imbalance. The Europeans are also being very limited in the capacity to invest in the Chinese markets. Companies, fearing an increasingly unstable regulatory framework in China, are reducing a lot of their investment in China.

Today we have 1800 European companies with operations in China, and most of them have suspended their investments. During the past year, 80% of the investment to China, have been made only by 10 multinational European companies, and half of them were German. So, in addition to the bilateral unbalanced relation with China, we also have very strong domestic imbalances in the EU, regarding our integration with the Chinese economy. And we know very well that Germany notably, accounts very significantly for the flows and exchanges with China. This says something also about the leading role that Germany has in the recalibration of the EU's strategy towards China.

It also means that the way we address this decoupling scenario, which is not only a scenario but now a reality, will have quite a different impact on the EU and on the US. We depend more on China for our exports, than the US does. Exports to China are about 15% of GDP on the EU side, and only 8% of GDP for the US. Our higher dependency for exports on China, vis-a-vis the US, puts us in a very complex situation in the decoupling debate.

We don't have the same capacity for joint investment at the EU level as the US does domestically, in replacing Chinese imports. Under the Biden administration the US is investing huge amounts of money for domestic capacities to replace some of their imports from China and so reduce their dependencies further. Nor do we have the same natural resources in the EU, as in the US, to relaunch mines of strategic minerals. But on the positive side, we have more Free Trade Agreements signed with trade partners in the world, and much more capacity for diversification of our imports and exports. So that also is a factor that is weighing on the European strategy.

Initiatives

What are the current initiatives that have been undertaken by the Europeans? What is the assessment that we can make of those initiatives? First, one key element has been the support to multilateralism, because obviously, the Europeans benefit much more from the preservation of multilateral rules, than from more power confrontation. On the US side, starting with Trump, the US had been switching from relying on dispute settlement at the multilateral level, heading towards a much more bilateral confrontation. On the European side, we continue to have this focus on multilateral rules with a willingness to reform the WTO, and to continue negotiating some new rules, pressing China to accept negotiation, and not only on subsidies, which remains a very high focus.

Then we have the agenda for the level playing field with trade partners. This has been launched already in 2020, with the control on foreign direct investment, which has allowed us to coordinate member states around some relevant criteria.

In addition to that, the European Commission has been developing a whole toolkit of autonomous trade instruments, allowing it to defend much more actively European companies from all the trade distortions, practised by China, but not only by China.

We have the instrument concerning reciprocity in public procurement, that has been adopted last year. And while there was a lot of debating between member states, finally, the adoption has been sped up by the beginning of the war.

Then we have the instruments concerning the control of foreign subsidies, allowing to limit the benefits that some foreign companies were having from important public service subsidies.

We have the carbon border adjustment mechanism which is still under discussion, and the anti-coercion instrument which is also still under discussion.

Obviously, the debates are really accelerating with the more important support from the European Parliament. And this provides the EU with a whole set of instruments that now will have to be implemented and the way they will be implemented, will also say something about the capacity for strategic autonomy of the EU and about exerting it.

An additional chapter is the capacity of the EU to reduce its strategic dependencies, more importantly in the field of raw materials. There has been some intensive work done to identify where we have those dependencies. The first assessment, led by the European Commission, showed that among 5000 products and goods, for 137 of them we had an important dependency, and for 34 of them, there were very hardly any substitutes. So, it showed the extent of those very strategic dependencies.

In addition, if we look at the 137 products of important dependencies, our dependency to China for imports is very pronounced, as high as 52%. So, the issue that was raised during the initial phase of the pandemic is very critical. If we look at our dependencies on imports of strategic minerals that is particularly critical. China for instance, is representing 90% of the capacity for the production and processing of rare earths, which gives it the power to exert some very aggressive economic coercion, if it was to limit exports to certain countries or companies in specific sectors.

Industrial strategy

The main strategy that Europeans have been developing is their industrial strategy. This includes all the important project of common European interest that had been developed for microchips, batteries, cloud systems and hydrogen and other. At the same time, we see that there's still some scepticism in some member states regarding the components of this industrial strategy, because some countries have more capacity for investment and for increasing their debt than others. There is still a lot of capacity in the way those projects are conducted. That would request a new governance, for the management of those industrial projects, that would request much more improvements and new capacity of funding. This can be new own resources, EU resources, additional contribution to EU budget, or additional common borrowing at the EU level.

An important element concerning the reduction of strategic dependencies, is that in addition to developing domestic capabilities, there's an important challenge for Europeans in terms of diversification of supply. And for that we benefit from the more than 40 Free Trade Agreement (FTAs) that we have already implemented, but also new, additional trade negotiations which are in progress.

On the other side of the Atlantic, we have the US that has completely renounced the strategy of trade negotiation. On the European side, there has been a complete reorientation of trade

policy and trade negotiations are really focused much more on sustainability, and on more conditionality, but at the same time, focus much more on the securitization of access to strategic materials and inputs.

We see that very well today with the negotiation with Chile, the point is not so much about market opening, the point is really to have access to the lithium reserves of the country by including in the trade agreements, to forbid any export restriction like the one that we have in the agreement with Canada, for example. This is why concluding the ratification of CETA with Canada has become so strategic. It is because we need to secure some imports particularly natural resources coming from Canada, in addition to all the other benefits that we have in this agreement.

We have another challenge which is concerning the promotion of European standards, and we need to work much more actively on that at the moment, when China is becoming much more ambitious and investing a lot of funds to develop its capacity for Chinese standards.

Failures

And to conclude on a more negative note, where Europeans are obviously failing, first of all, is on the coordination of the increased efforts on defence capacities. Following the start of the war in Ukraine, the member states have decided to invest more in defence. But all the member states are moving unilaterally on this issue. And we are failing to have some common projects of military capabilities and to coordinate a future strategy to develop defence industries at the European level. And considering the huge financial resources that are invested, we may miss a turning point for the European strategic autonomy.

And the second main element, is the failure to coordinate on a European strategy on China. Because at the moment, we have a European Commission that has a much clearer view on the way to address China, but between the member states, we continue to be quite divided on the way to address China. This is a structural deep challenge. Germany has a key role. Currently Germany is preparing a strategy on China, recalibrating its relation, with China. It obviously would have an impact on the European approach to China and the positioning of the EU between the US and China. And there might be a role for the EU to try to balance the relation to avoid the confrontation of two blocks, keeping in mind that a more isolated China may become also much more aggressive, and that we should really anticipate this scenario. It requires some intensive strategic thinking to address this issue and then much more solidarity between the member states.

Conclusion

And just to conclude at this stage, what we see is that Europeans may be tempered by strategic fatigue, because they are faced with inflation challenges and a lot of domestic challenges. But it is precisely a moment when we have to engage much more closely with



third countries in Africa and in Latin America and trying to avoid this confrontation of the two blocks, and instead try to get closer with other partners.