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EU and China between De-Risking and Cooperation: Scenarios by 2035

Edited by **Sylvie Bermann**
and **Elvire Fabry**

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Introduction

Never before, since China embarked on its journey of openness and modernisation over 40 years ago, has the country's political and economic future, along with its global ties, been shrouded in such a thick fog of uncertainty.

The roaring economic engine that, over thirty years, lifted 800 million people from the clutches of poverty and catapulted the country to the status of the world's second-largest economy is now losing steam, particularly since Beijing adopted its stringent zero-Covid policy. In October 2023, the International Monetary Fund recalibrated its economic outlook for China, trimming its GDP growth projections from an expected 5.4% in 2023 to 4.6% in 2024.[1] The once clear runway for China to overtake the United States at the top of the podium is now clouded with doubt. Analysts are increasingly wondering whether China has hit its peak and is now on a trajectory akin to Japan's, marked by an ageing population and unparalleled demographic decline—a path so steep that the UN predicts a loss of over a third of its population by the end of the century. The burning question is whether Beijing can solve problems that have become structural: a shaky housing market, weak consumer spending, high youth unemployment, and debt-saddled provinces. It will be particularly vital to breathe new life into the private sector, a wellspring of job creation and cradle of innovation, in stark contrast to state-owned enterprises that are often propped up by the government. However, sounding the death knell for China's economic growth is premature. China could very well experience an economic surge by harnessing the power of artificial intelligence and supercomputing. It could continue to defy expectations, just like it did when posting record-breaking exports of electric vehicles (EV)—this coming from a country once bereft of expertise and brand recognition in the sector. Owing to a 76% surge in EV exports in the first quarter of 2023 compared to the previous year,[2] China officially surpassed Japan as the world's top auto exporter.

However, it's important to avoid jumping to conclusions, both concerning China's economic slowdown and its technological lead, suggested by a growing number of patent filings across the country. What's needed is an empirical approach to evaluating comparative advantages

1 IMF, 7 November 2023.
2 China Association of Automobile Manufacturers, June 2023.

across different sectors and technologies, a task that calls for a considerably more ambitious level of technological vigilance and foresight at the European level. For several decades, China has leveraged a comprehensive intelligence system to monitor and dissect openly available scientific information from around the globe, a system that artificial intelligence will only sharpen and enhance.

From a political standpoint, Xi Jinping symbolised a fresh promise for modernisation and openness when he came to power in 2012, advocating a "neither nor" policy—neither criticising Mao Zedong's policies nor those of Deng Xiaoping. Today, however, the Chinese leader seems to be leaning more towards the former statesman, adopting an increasingly ideological stance and tightening the Chinese Communist Party's grip across all facets of life, including society, culture, education, and the economy, even if that means reining in the economic growth that has been central to China's ascent from geoeconomic to geopolitical prominence. Xi's grip on power is unmatched since Mao's era, yet the mysterious disappearance of two high-ranking associates, the Ministers of Foreign Affairs and Defence (both recently named Chinese State Councillors), is raising eyebrows. Incidentally, the task of deciphering these political developments has become more challenging than ever for both foreign and Chinese observers alike.

In the realm of geopolitics, the Chinese government is adopting increasingly nationalist and radical positions. Beijing doesn't shy away from clashing with its neighbours and slapping them with sanctions. As a result, Australia, long mesmerised by China, shifted its allegiance to join the United States in the Quad alliance, aiming to contain China's growing influence. Many Chinese and Taiwanese, who once believed that Beijing would never invade Taiwan, are no longer so sure, especially in light of the Chinese military flexing its muscles and Washington's occasional provocative posturing.

The confrontation with Washington will remain the cornerstone or, more aptly, the wrench in the machinery of international relations. The Thucydides Trap, marked by the somewhat paranoid attitude of the established power facing a rising, intolerable rival, is not off the table, in spite of perceptions that China's economy has stalled. The new Cold War, sparked by a technological blockade initiated in 2019 by Donald

Trump and intensified under Joe Biden, is set to be a protracted affair spanning decades, with alternating periods of sharp tensions and brief thawings. Efforts to defuse tensions through high-level diplomatic engagement between Beijing and Washington have not been enough to halt the trend towards more aggressive technological decoupling. Retaliatory gears are in motion. The launch in August of Huawei's 5G Mate 60 Pro smartphone, featuring 7nm chips made in China despite U.S. sanctions, prompted new American restrictions in October on Dutch chipmaker ASML, aimed at curbing its export of lithography technology—vital for chip manufacturing—to China. Beijing wasted no time responding, expanding the scope of critical chipmaking minerals subject to export controls. After imposing restrictions on gallium and germanium compounds (the production of which is nearly monopolised by China), Beijing's focus shifted to graphite, an essential mineral for battery manufacturing, and to rare earths..

The big picture is equally uncertain and contradictory. Moscow's war of aggression against Ukraine marked a major strategic shift in Europe. But it also revealed a profound transformation of the world order, one where the democratic West is losing its monopoly on power and influence while major players in the Global South embrace the multipolar world long championed by Beijing and Moscow. What India and South Africa call 'multi-alignment' manifests as a form of diplomacy that is transaction-based and non-aligned, effectively unshackling them from Western alliances. A prime example is Saudi Arabia, which has shifted away from Washington and joined the grouping of BRICS nations. Organisations once viewed condescendingly by the West and overshadowed by the high-profile summits of the so-called world's most powerful nations within the G7 framework are now drawing new members. And China is at the helm. The prospect of de-dollarisation, though not imminent, is a growing concern for the United States, which may find it harder to enforce its policies through extraterritorial sanctions. Moreover, China is emerging as a full-fledged diplomatic powerhouse, as evidenced by its role in brokering peace between long-time adversaries Iran and Saudi Arabia, challenging the U.S.'s traditional sphere of influence. This new trend of shifting global power dynamics is likely to continue. The world is now fractured, and conventional platforms of global governance, from the United Nations Security Council to the G20 (the only meeting ground where different global powers could still come together to discuss world issues), are paralysed. Reconstructing international order cannot be exclusively led by Western powers.

While the goals and actions of the world's major players are more or less transparent and driven by clear interests, a question mark hangs over the European Union. The bloc's cohesion, strengthened by its support for Ukraine, may weaken after the conflict comes to an end. The primary challenge for the EU is achieving strategic autonomy, which will be defined by its ability to act independently of Washington and Beijing. The United States, having provided considerable military support to a European country, will undoubtedly expect something in return. Eastern European nations, which had once flirted with closer ties to Beijing through the 17+1 group, are now expected to close ranks. The countries of "Old Europe," focused on the influence and role of the EU, will tread more cautiously. A minimum level of cooperation between Paris and Berlin will be crucial in this geopolitical landscape. The German Chancellor is navigating a complex political situation. In pursuit of a new approach towards China, even as his coalition pulls in different directions, Olaf Scholz, having lost Russia, is determined not to lose the economic benefits of China's vast market for German businesses.

For the European Union, the question is an existential one. In a world reshaped by the Covid-19 pandemic and the Ukraine war, Europe has opted to wean off its heavy reliance on essential products, especially from China. Its approach, however, remains more measured than that of the United States. Indeed, while the European Union established established a coordination of foreign direct investment control conducted by the member states and developed an arsenal of trade defence tools (including an anti-coercion instrument), Brussels has adopted the pragmatic de-risking approach as opposed to the radical decoupling strategy endorsed by the hawkish elements in Washington. This concept, coined by the President of the European Commission, has even been embraced by the U.S. National Security Advisor, Jake Sullivan, evidence of the EU's potential influence on global economic strategies.

In an uncertain world transitioning between an old world that hasn't yet died and a new world yet to be born—what Gramsci describes as "the time of monsters"—the European Union's balanced approach, ability to set international standards, and creative thinking could pave the way for a third path. The EU's relationship with the United States and China is not and should not be seen as equidistant or neutral. Washington is an ally; Beijing is a partner, competitor, and rival all at once. Europe must avoid a black-and-white, good-versus-evil worldview. Instead, it should make pragmatic decisions based on each specific situation and its own interests. It should work on building and defining partnerships with China while strengthening its global influence through the broad network of international agreements developed over time. In this regard, infrastructure projects under the EU's new Global Gateway programme could serve as an alternative or complement to China's Belt and Road Initiative (BRI). Europe's involvement in these partnerships—especially in the context of the BRI that offers access to green technologies for emerging countries—is critical because it can counteract criticisms of the EU's so-called "green protectionism" and "regulatory imperialism."

The European Union stands at a crucial juncture where its success or failure in harnessing disruptive technologies, seen as amplifiers of power, could tip the balance of power and lead to a swift reversal of power dynamics. The ongoing war in Ukraine and the potential escalation of conflict between Israel and Palestine add layers to the already complex geopolitical landscape, further fragmenting international relations and stability. The EU should not merely respond to events as they occur but aim to play a role in easing global tensions. In the face of growing short-term uncertainty, exploring medium-term scenarios towards 2035 could help European policymakers safeguard the interests of member states. Beyond the current trend where power politics dominate over adherence to international rules, the EU must anticipate critical tipping points resulting from judgments or arbitrations that could adversely impact the bloc.

In the wake of the first report published in December 2021 titled "Building Europe's Strategic Autonomy vis-à-vis China," the Jacques Delors Institute summoned a group of experts to sketch out possible scenarios on critical aspects of the relationship between the European Union and China. For each issue, the experts were tasked to pinpoint the most crucial factors that could shape how the relationship progresses and to freely explore potential future developments.

These scenarios are not mutually exclusive. They do not follow a straightforward, predictable path across different sectors but vary depending on whether they predict cooperation or conflict. The intention is not to outline a few overarching scenarios, but to bring attention to the complexity and intricacies involved. A more detailed study would be needed to understand the ripple effects that European strategic decisions might have across different sectors. But this tapestry of scenarios illustrates that, in pursuing strategic autonomy, the EU cannot rely on a single-faceted approach towards its relations with China. A nuanced and multifaceted strategy is needed. Rather than summarising the recommendations for each scenario, the focus here is on outlining the critical junctures that could undermine or bolster the EU's strategic autonomy.

The first issue on the docket is whether there will be a slowdown in China's economy over the next decade and how this would impact the "reorientation of trade along geopolitical lines" observed since the onset of the war in Ukraine. The increase of trade within specific groups since February 2022 has already reach between 4% to 6%.[3]

A rebound in China's economy could fan the flames of the Sino-American rivalry, leading to a surge in coercive tactics. For Europe, this scenario would pose a critical dilemma: the EU relies on China for certain technologies crucial for its energy transition, but the bloc also depends on the U.S. for security guarantees, which may come with increased stipulations in such a heightened geopolitical climate. Similarly, a scenario where the growth rates of the U.S. and China diverge significantly, along with a split in their technological and regulatory frameworks, would increase demand for European technologies from Chinese companies. It would also require careful monitoring at the European level to prevent the unauthorised transfer of critical technologies.

The EU's economic security strategy, initiated in June 2023, must focus on maintaining scientific cooperation. This is vital to preserve the EU's access to American and Chinese technological advancements (even if China's innovation were to slow down if it concentrates only on a few key sectors). European countries must coordinate efforts to limit technology transfers and rethink scientific and technological governance without cutting themselves from Chinese innovation. This could bolster their innovation prowess in critical sectors like space exploration,

3 World Trade Report 2023, WTO.

quantum computing, and semiconductors. However, should geopolitical tensions lead to a growing disconnection between the EU's innovation systems and China's, Europe's progress in innovation could face a significant slowdown—a point of major concern since U.S. companies might continue to benefit from Chinese innovation despite Washington's official narrative on technological decoupling. The EU could use its new trade defence instruments to steer China towards fairer competition. By doing so, Beijing could be enticed to adopt better practices for scientific cooperation, which would benefit not just China's but also Europe's capacity for innovation across a broader range of sectors.

European countries must adopt a two-pronged approach. First, they need to combine their economic intelligence resources to monitor and understand the American and Chinese innovation systems and evaluate their comparative advantages. Second, they should develop tools that enhance and structure scientific cooperation more effectively while encouraging China to participate in a global governance system that facilitates access to major research infrastructures.

Efforts to achieve a harmonious balance of environmental, social, economic, and territorial sustainability will increase the European agricultural and food sector's reliance on external demand, just as China actively diversifies its import portfolio to secure its own food supply. Whether European food products become less important in global markets, losing out to Russian products along the way, or China reduces its dependence on imports through innovation in food production, Europe risks losing leverage in balancing its trade, particularly in reducing dependence on imports from China. Steering the EU's agricultural strategy to satisfy the burgeoning appetite of China's middle class for high-quality European food products, if implemented within a mutually beneficial trade framework, could not only enhance Europe's position but also align Sino-European interests towards the shared goal of greener agriculture.

Decarbonisation is now viewed not only as a crucial global concern (defending the environment, a public good) but also as an arena where major world powers compete technologically and economically. Given the geopolitical frictions that would arise, on the one hand, with the United States if Brussels aligned with Beijing to access green technologies and components (where China holds a near monopoly), and on the other hand, with China if Brussels opted instead to strengthen its ties with Washington, the EU is compelled to fast-track its reindustrialisation. The EU's ability to remain competitive is also vital to sustaining ambitious international aid efforts aimed at bridging the North-South divide in addressing climate change, a factor that will shape its influence on the global stage. By making its climate aid efforts more visible in developing countries, the EU can secure better access to crucial raw materials needed to produce green technologies in Europe.

China's stranglehold on the production of certain strategic goods and technologies puts Europe at risk of economic arm-twisting, where China could either restrict access to these goods or command an exorbitant price tag. Europe must fine-tune its de-risking strategy to reduce its excessive reliance on critical sectors controlled by China. This strategy, now viewed as a matter of economic security, requires a sector-by-sector risk assessment that considers different risk factors. A shared methodology for assessing European risks is essential for a coordinated and effective de-risking strategy. However, there is a growing trend away from a stable global trade environment towards increasing fragmentation and tension, with the risk of an assault on Taiwan sparking a broader international conflict and solidifying transatlantic alignments. Europe's de-risking strategy should include making China aware of the potential economic downsides of its push for self-sufficiency, including greater isolation and a slowdown in technological innovation.

The breakdown of the World Trade Organization's (WTO) multilateral regulatory framework could lead to two different scenarios: one where non-exclusive regulatory frameworks are formed around major economies and another where more exclusive, potentially restrictive frameworks are established. Creating a WTO 2.0, built on the European Union's core principles of fairness, transparency, and predictability, would aim to enhance global well-being. In this reimagined framework, the EU could advocate for the needs of emerging economies, offering them more flexible industrial policies, if and when requested, in exchange for their commitment to environmental issues prioritised by Europe.

The EU might continue to endorse China's efforts to de-dollarise international trade. However, while backing the move away from the U.S. dollar might shield the EU from Washington's extraterritorial legal measures, any support for the broader use of China's renminbi should be contingent on a proactive strategy to internationalise the euro. Conversely, if closer ties with the United States lead the EU to downplay the Chinese currency, it becomes imperative to advocate for a more inclusive monetary system, especially for the diverse countries of the Global South, to prevent isolation that could hinder the euro's outreach in these regions.

The Association of Southeast Asian Nations (ASEAN) collectively stands as the EU's third-largest trading partner after the United States and China. In a landscape where both U.S. dominance and Chinese influence can sway Southeast Asia, the EU could play a strategic role for ASEAN countries by offering an alternative partnership. By strengthening bilateral relations with ASEAN, the EU can provide these countries with more options beyond having to choose sides between the U.S. and China. However, China's efforts to expand its global reach in Southern countries extend beyond ASEAN, involving other regional partnerships such as ASEAN+3 (that includes Japan and South Korea), the Regional Comprehensive Economic Partnership (RCEP), the Shanghai Cooperation Organisation (SCO), and the BRICS+ group. Several factors will influence the regional and global political landscape, leading to complex and sometimes conflicting situations, especially for countries like India, which pursue a policy of multi-alignment with different and sometimes competing international blocs. In this intricate geopolitical dance, a strengthened EU-ASEAN relationship could play a pivotal role in balancing China's growing sway in the broader Global South, a region acutely aware of Beijing's strategic moves.

Our report concludes by looking at Taiwan. The issue must be addressed proactively by analysing how the threat of sanctions might deter China from attacking the island nation, which could trigger broad decoupling in global relations and have significant international repercussions. However, the dependence of European companies on China might be preventing a thorough consideration of sanctions. As a result, an acceleration in the de-risking process is encouraged. There is also the need to prepare the European public for the potential efforts and costs associated with defending the democratic principles upon which the EU is founded, principles that are vital for maintaining the EU's unique identity in a pluralistic world.

These different scenarios highlight the significant challenges the EU will face whether China becomes more aggressive and assertive or more self-reliant and autarkic. Acknowledging the high cost that China would incur by not cooperating on the global stage might lead to a strategy of controlled coexistence, uncompromising and framed by specific commitments from China, not only in direct dealings with the EU but also within broader international forums and organisations. The European Commission's move to launch a probe into China's subsidies for EVs imported into the EU, which could extend to other Chinese technologies (e.g. wind turbines), is a sign of the EU's stronger determination in its policies concerning China. The EU has armed itself with new tools to enforce trade defence measures independently. Using these tools will become a crucial part of the EU's broader economic security strategy, emphasising rules-based action and the collective resolve of member states to seek greater reciprocity from China, aiming to balance systemic rivalry with partnership and competition.

Sylvie Bermann
Elvire Fabry

1.

China's Short-Term and medium-term economic outlook: What should European companies expect

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I . Even if supported by the reopening, China's short term economic outlook looks bleak

A recovery in consumption has occurred since mobility restrictions were lifted at a national level last December but the recovery is concentrated in the service sector with consumption growing negatively compared to 2021. This is true for auto sales but even more so for housing, whose demand remains stagnant. The Chinese economy woes are even more serious when turning to fixed asset investment whose growth continues to be underwhelming even when compared with the zero-covid peak year of 2022. Fixed asset investment in real estate remains highly negative but also those into manufacturing and infrastructure continued decelerating despite positive growth. In the same vein, industrial production remains subdued as industrial profits are plummeting with two-digit negative growth for the first seven months. The external sector, the once most important engine to the Chinese economy, also worsened recently, with exports turning to negative growth since May 2023. July even saw the biggest plunge in exports in more than three years, which fell 14.5% YoY compared to a year ago. Still, China's trade surplus remained resilient due to the highly negative growth of imports, which may have created the conditions for a positive contribution of external demand to China's growth. However, the external sector is clearly deviating from its state of the growth engine as the trade slump persists.

On the policy side, signs of weakening have prompted additional support to shore up the economy. Since June, the People's Bank of China (PBoC) has conducted two rounds of cuts in key interest rates and recently lowered reserve requirement for commercial banks to ensure ample liquidity and economic recovery. Moreover, easing measures in the real estate sector have also been rolled out, with mortgage rules loosened to spur housing demand. Unless the economy turns quickly, it is very much likely that more support would come to help. However, room for fiscal support remains limited with public debt piled up during the last few years all the way to 100% of GDP. The renminbi (RMB), which is already on a depreciation path, will feel growing pressure if the monetary discrepancy with the Fed further widens.

All in all, the underwhelming GDP growth target of 5% which was set by outgoing premier Li Keqiang during the Two Sessions[1] last May and confirmed by the current premier, Li Qiang, looks now just about right and, if things continue like this, possibly even challenging.

II • From 2024 the winds of structural deceleration will be even more evident

Next year will be even more challenging as the positive base effect[2] which has driven growth this year turns negative. While the government has already stepped-up stimulus measures and possibly even more to come in the next few months, it might still not be enough to avoid a renewed deceleration of growth heading towards 4% a year. Support might be easier on the monetary front as the FED is expected to start cutting rates. Lower rates in China will also become increasingly important for the sustainability of public debt.

Another source of concern stems from the private sector. No matter the need for growth, the government is unlikely to implement a permanent 180-degree turn in its current policies designed to rein in the private sector. As long as the Xi Jinping-led regime remains convinced of the superiority of China's economic model – which is tightly linked to the political model – there will not be a structural change, in terms of a larger role to the private sector.

1 Two Sessions refers to China's annual parliamentary meetings, where the two main political bodies of China - the National People's Congress (NPC) and the National Committee of the Chinese People's Political Consultative Conference (CPPCC) - reveal China's main policy objectives.

2 Compared with the same period last year.

III . Two scenarios going forward

China's long-term growth is bound to come down, but the speed of such structural deceleration will depend on several factors.

- **Scenario I - Baseline scenario for 2035: the economies of China and the US are neck and neck.**

The baseline scenario for structural deceleration can be taken from a standard convergence model in which labour productivity decelerates as China's income per capita increases, in line with other economies having left the benchmark of 10.000 USD per capita. The result of such exercise points to China's growth decelerating until reaching 2.4% by 2035. This implies that China's growth will be 40% of what it was prior to the pandemic but China's GDP growth should still reach US$ 30 trillion by then, which should be very similar to the size of the US economy in 2035. In other words, a baseline scenario of China's growth projections points to the US and Chinese economy being very similar to each other by 2035 and remaining so as China's growth will not be higher than that of the US from 2035 onwards. If anything, it may be lower as the negative impact of ageing on growth deepens from 2035 onwards, detracting about 1% point of growth annually. It is also important to note that China should overcome the middle-income trap in this baseline scenario, with an income per capita which could reach US$ 25.000 by 2035.

IMPLICATIONS FOR THE EUROPEAN UNION

As the Chinese economy becomes as large as that of the US in US$ terms by 2035 and its income per capita overcome the middle-income trap, China's market should remain attractive for European companies. For trade, though, China's push for self-sufficiency, as we are already seeing in the negative growth of imports even when the economy is growing more than in 2022, might reduce the attractiveness. What is more important, China's relentless move up the ladder will create additional headwinds for European companies in third markets. Those companies having invested in China, through foreign direct investment, might enjoy the larger size of the Chinese economy and higher income per capita as far as the increasing regulatory constraints (from national security to data protection) allow it.

Beyond the companies exporting and operating in China, the consequences for the EU as a whole will depend on other factors, including how the EU might have managed to de-risk its excessive dependence on China, especially on the energy transition. US-China strategic competition will also play a role given the EU's dependence on the US for security, even more so since the war in Ukraine.

- **Scenario II - Longer long-term growth due to the challenges faced by the Chinese economy.**

The previous baseline scenario hinges on several risks, starting with an even lower return on assets as a result of over investment but also of potential technological hurdles stemming from the US tech containment, especially on the semiconductor front. Another important risk is the rapid pile-up of debt and what it means for the productivity of the Chinese economy. Finally, Covid scarring, but also heightened capital-intensive investment leading to rapid robotization of the industrial base, is reducing the number of jobs available in the Chinese economy and pushing youth unemployment to record levels (21.3% in June).
Overall, one could take Japan's path of growth deceleration as a benchmark for China. This would push GDP growth by 2035 at around 1.5% which is lower than the US implying a divergence, rather than convergence between the two, as is the case of the US and Japan today.

IMPLICATIONS FOR THE EU

In this second scenario, EU companies will benefit less from China both in terms of exports but also in terms of their profits from their foreign direct investment. The extent of the change will depend on how serious these challenges might become but also how much China might be able to mitigate structural deceleration through innovation, whether it is indigenous or through alliances with other partners. Against such backdrop, one should expect China to become increasingly interested in European technology as the US steps up its containment. The EU should pay more attention to such tech transfers. Another important consideration of this scenario is potential technological bifurcation as well as that of standards. The EU stands to lose a lot from this scenario.

2.

A China-EU Partnership in Science and Technology?

Irène Hors
Chairman of Steering Committee
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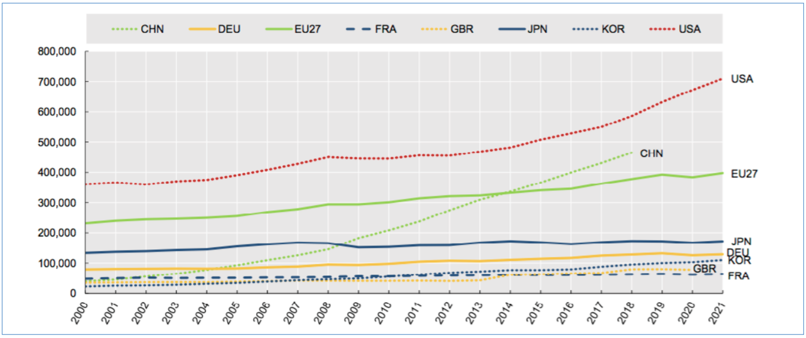
I. Introduction

1978 was a watershed year for China as the country opened its doors to the world and kick-started its journey of sweeping economic reforms. But it was also a turning point in science and technology (S&T). At the National Science Conference held that year in Beijing, Deng Xiaoping underscored the importance of “mastering modern science and technology” to turbocharge China’s economy and modernise the nation[1].

However, China’s substantial growth in research and innovation wouldn’t kick into high gear until the early 2000s. Several indicators bear witness to China’s meteoric rise over the past twenty years[2]. For example, annual spending on R&D is drawing close to levels seen in the U.S. and has far surpassed European Union expenditures.

FIGURE 1. National R&D expenditures, 2000-21
(in million USD, at constant PPP prices)



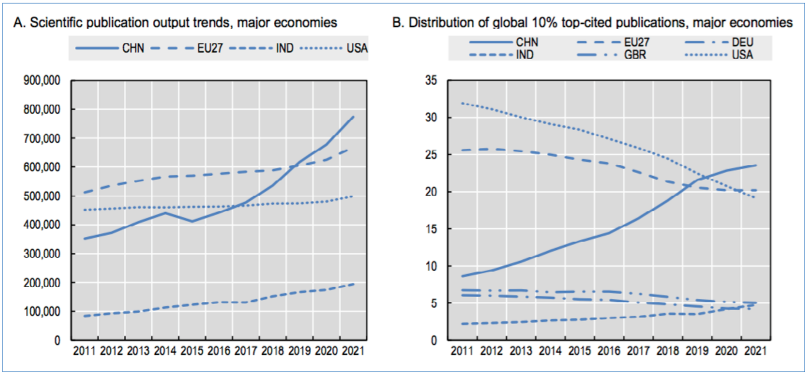
▲Source: OECD (2023) .
Note: Recent data for China has not been used as it is currently under review by the OECD.

1 “The crux of the Four Modernizations is the mastery of modern science and technology. Without the high-speed development of science and technology, it is impossible to develop the national economy at a high speed.”

2 It’s hard to grasp China’s true might using current metrics, just as it is for other countries and regions. Data on inputs and outputs - such as publications, citations, and patents - only offer a partial view of a country’s innovative pulse.

In 2019, China surpassed Europe to become the leading source of scientific literature after overtaking the United States in 2017. It also solidified its standing as the primary source of publications among the top 10% most cited worldwide after overtaking the EU and the United States in 2019 (Figure 2). Since that same year, the overall quality of its scientific publications has been on par with that of Europe, with just over 10% of the publications being among the top 10% most cited worldwide, compared to 13% for the United States. China also displays rapid growth in the number of patents granted to Chinese companies, both within China and abroad.

FIGURE 2. Trends in scientific publications, 2011-21

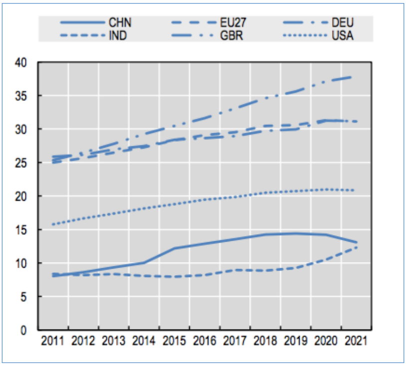


▲ Source: OECD (2023). OECD calculations based on Scopus Custom Data, Elsevier, Version 1.2023, March 2023, and Scimago Journal Rankings.

While China established a national agency in the late 1950s to systematically gather and study open sources of science and technology intelligence from foreign countries[3], Beijing began to gradually embrace international collaboration with OECD countries in the 1980s. To this day, however, the level of China's international scientific cooperation still falls well behind that of the United States and Europe (Figure 3).

3 See Hannas, W., & Chang, H.-M. (2021, January). China's STI Operations. Center for Security and Emerging Technology (CSET)..

FIGURE 3. International scientific collaboration rates, 2011-21



▲ Source: OECD (2023).

In 2001, China joined the OECD's Committee for Scientific and Technological Policy as a "Participant," thus gaining access to comparative analyses of the policies pursued by developed countries. However, China did not commit to the OECD Council's Recommendation on International Cooperation in Science and Technology (adopted in 1988, amended in 2021)[4] nor the Recommendation for Facilitating International Technology Cooperation with and among Businesses (adopted in 1995, amended in 2022)[5].

II • Three scenarios for 2035

While China has already established itself as a major global power in science and technology, contending with the U.S. for global leadership

4 The purpose of this Recommendation is to provide guidance on how Members and non-Members having adhered to this Recommendation (hereafter the "Adherents") can engage in and promote international co-operation in science and technology that is mutually beneficial and contributes to sustainable development, removing barriers which have harmful effects on scientific and technological progress and its contribution to inclusive economic growth and social well-being, and taking into account the role of public research organisations and other relevant stakeholders.

5 OECD legal instruments. (2022). https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0282

in strategic sectors, can Europe safeguard its assets and hold its ground in this global contest? As the European Union gears up to establish an economic security strategy, what relationships can it forge with China in science and technology to foster fruitful collaboration? We raise three scenarios to stimulate reflection.

SCENARIO 1: CAUTIOUS OPTIMISM

China struggles to turn its innovation potential into success. Europe holds its ground in international research and treads carefully in its dealings with China. Taking advantage of weaknesses in Europe's innovation system, China has a knack for spotting promising European innovations and adeptly exploits them for commercial gain.

- Astonishing records in terms of patents filed and articles cited overstate China's true scientific and technological prowess.
- Political tightening and the ever-present threat of falling prey to China's anti-corruption campaign hinder initiative and risk-taking. High-performance expectations and the threat of sanctions in case of failure stifle the creativity of researchers at major public and private research institutions. The brain drain and exodus of entrepreneurs gain steam.
- Efforts to catch up with developed countries, especially through vigilant monitoring of open-source intelligence, begin to show diminishing returns.
- However, China makes significant strides in certain areas where access to extensive databases (e.g. genetics, artificial intelligence) or large research infrastructures is a game changer.
- Meanwhile, Europe beefs up its precautionary measures to govern scientific and technological collaboration with China. Major research teams are increasingly reluctant to collaborate with China as government-imposed screening mechanisms become more stringent.
- The EU also successfully implements coordinated restrictions on the export of sensitive technologies. However, China still finds a way to acquire new pertinent technologies, particularly those that struggle to secure enough capital and confidence in Europe to develop fully.
- Large European companies continue to conduct a portion of their R&D in China, leveraging China's comparative advantages and proximity to the Chinese market while protecting the critical assets that will help them remain competitive in the future. China gains ground in

other markets, offering a competitive blend of technology and "borrowed" expertise from companies operating in China, coupled with clever adaptations.
- Having awakened to the need to overhaul its S&T governance to reduce strategic dependencies, Europe takes steps to bolster its R&D capabilities and curb the brain drain and the exodus of start-up entrepreneurs to the United States. European scientists and industry players develop new technologies in nuclear energy, space exploration, quantum computing, and the production of semiconductors.

SCENARIO 2: VICIOUS CIRCLES

China grows stronger. Europe becomes isolated and loses ground.

- Concerned about preserving its knowledge and integrity, Europe overlooks China's budding prowess in science and technology, failing to adapt accordingly.
- The prevailing narrative, echoed by media and politics, maintains a steadfast negative stance towards China, which hampers the process of finding middle ground and integrating a deeper understanding of China's complex realities and Europe's interests in policymaking.
- Partly owing to pressure from the United States, whether overt or not, increasingly restrictive measures are put in place to limit exchanges and collaboration between Europe and China in science and technology. With the Russian invasion of Ukraine in the back of everyone's mind, the spectre of a conflict with China prompts public and private stakeholders to reassess partnerships, leading to a widening gap in the collaboration of innovation systems. Not wanting to seem like it's singling out China, the EU extends its restrictive policies to other non-European countries, further isolating its innovation system from global collaboration.
- Despite the headwinds, European companies continue to conduct some of their R&D with China and invest there. Those that China views as technologically promising are courted, but their room to negotiate terms is dwindling. Forced technology transfers continue, gradually undercutting the ability of these companies to thrive in Chinese ventures.
- In contrast, the United States successfully safeguards its interests and comes out on top. Notwithstanding their stern official rhetoric, key players (e.g. companies and major universities) persist with

investments and research collaborations, capitalising on China's comparative advantages (large databases, research infrastructures, skilled workforce). This approach allows them to keep abreast of advancements being made in China.

- China gains solid ground in pivotal sectors like biotech, artificial intelligence, transportation, and green technologies. But the U.S. stalls China's progress in the semiconductor and quantum computing arenas.
- Caught between the competing interests of the U.S. and China and hamstrung by internal strife and disagreements, Europe's science and technology sector falls behind. This results in spiralling dependence on the United States, which gradually assumes remote control over Europe's destiny.

SCENARIO 3: VIRTUOUS CIRCLES

Driven by growing technological decoupling from the United States, China attempts to forge a closer, more beneficial relationship with Europe.

- Europe continues to level the playing field, adopting measures that make operating conditions at home comparable to those in China. In addition, Europe strengthens control mechanisms on partnerships, exports, and investments to prevent technology from being transferred without appropriate checks.
- Beijing recalibrates its increasingly costly style of international policy to foster a closer relationship with Europe. Examples include adopting a more positive attitude towards the Carbon Border Adjustment Mechanism (CBAM) and taking steps to improve market access in sectors related to the climate transition, in line with the annexes of the former EU-China Comprehensive Agreement on Investment (CAI).
- Aware of its shortcomings and the value of collaborating with Europe in science and technology, China implements measures to ensure good conduct. These include addressing past mistakes and failures, accepting the conditions set by the Commission in terms of S&T cooperation, and creating a dedicated Leading Group led by a Vice Premier that effectively puts an end to forced technology transfers and enhances the protection of intellectual property rights.
- Along with Germany, France spearheads efforts in 2024 to breathe new life into Europe's partnership with China, including in the realm of science and technology—an opportune time to do so given that 2024 marks the 60th anniversary of diplomatic relations between France

and China, the China-France Year of Culture and Tourism, and the year of the Paris Olympic Games.
- Major European research organisations meticulously assess the pros and cons of collaborating with China, identifying past missteps, biases through which Europe inadvertently "gives away" more than intended, and effective governance solutions.
- Against this reshaped backdrop, new partnerships between Europe and China allow significant progress in sectors such as medicine, biotech, and green technologies–, which benefit both powers.

III • Recommendations for Europe

The recommendations formulated in the first report of the Jacques Delors Institute[6] remain relevant:
- Improve the documentation of Europe-China STI collaboration, its scientific and strategic benefits, and challenges for a shared European vision.
- Better understand the international strategy of the Chinese innovation system.
- Develop a European instrument to regulate technology transfers to China and other non-democratic countries. Establishing controls over certain outbound strategic investments, as recently proposed by the European Commission in the context of its economic security strategy, is a step in this direction.
- Develop tools for a more targeted approach to collaboration with China through a greater understanding of European and Chinese assets.

From the scenarios discussed above, three additional recommendations emerge:
- Monitor the progression of collaboration between the United States and other non-European leading countries with China in science and technology.
- Mobilise OECD countries to encourage China to comply with the OECD's Recommendation concerning Principles for Facilitating International Technology Co-operation Involving Enterprises.Strengthen the global governance of access to large research infrastructures.

6 (dir) Fabry, E., & Bermann, S. (2021). Building Europe's strategic autonomy *vis-à-vis* China - Report 124. Institut Jacques Delors. .

3.

China’s Dependence on Food Imports

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Since the turn of the century, China's population has grown by 160 million, emphasising the critical role of food security in its political and geopolitical strategies. The Covid-19 pandemic highlighted the resilience of Chinese society in the face of myriad hardships, save for one – a lack of consistent access to food. Beijing thus recognises the importance of maintaining a strategic focus on food security.

In this context, several scenario hypotheses can be put forward, with multiple nuances and combinations possible. We have deliberately chosen to crystallize the range of possibilities around three macro-scenarios, the sole aim of which is to encourage strategic reflection and appropriate action in the context of Sino-European relations in the years ahead.

I • Scenario I – China produces less, its dependencies increase, and geopolitical considerations take centre stage.

- The challenges ahead are complex, especially in light of depleting natural resources, continued urban sprawl, and increasing desertification in some regions. To the younger Chinese generation, the Chinese Communist Party's narrative, which extols the virtues of agriculture and the rural heartland as linchpins of national harmony and balanced growth, seems to resonate a little less. This generational shift manifests in a waning interest in agricultural and agro-industrial vocations, coupled with an increasing disaffection for rural life. Conversely, the magnetic pull of the service sector and the bustling megacities of the eastern coastline have never been more compelling.

- To ensure food security, China needs to maximise domestic production using innovation to overcome geographic constraints, albeit with diminishing returns compared to the last three decades of the 20th century. Beijing must also cultivate a nuanced international relations framework, tailoring its approach by product, country, and situational context. Many of the world's agricultural powers prioritise their relationship with China despite being fully aware of the dependency risks associated with this voracious yet increasingly discerning market. "Discerning" because Beijing adeptly wields economic diplomacy to its advantage, and Chinese consumers increasingly demand safer and healthier food products. Brazil remains a primary agricultural and food supplier to China. However, Brasilia begins to rethink the mid-to-long-term trajectory of this alliance, especially as South American neighbours criticise Brazil for catering to the Asian giant's demands at the expense of the region's ever-growing needs. By the end of the 2020s, Brazilian authorities hint that they might reconsider their strategies in the 2030s to prioritise and promote locally sourced agricultural and food products.

- The United States, ever eager to supply China, sees exports to China break new records during the 2020s (with China accounting for an average of 20% of all U.S. global agricultural and food sales), driven by the insatiable appetite of China's vast 1.5 billion-strong population. However, escalating military tensions and Beijing's strategic move to decrease its reliance on Washington begin to shift the nature of the Sino-American trade relationship away from agriculture. The once distinct divide between trade and politics is now blurred. China recognises that it must diversify its agricultural and food supply sources. Adjacent Asian nations offer some initial breathing room. Indonesia, Vietnam, and Thailand ramp up their production for China, which holds sway over the logistical and financial sectors within these states. Meanwhile, India also steps up its exports to China despite prevailing geopolitical tensions between the two demographic giants. Beijing understands that its relationship with New Delhi is fraught with uncertainties. Beyond the unpredictable harvests due to India's increasingly erratic climate, the Chinese government knows that India could pivot away from China with the rise of Hindu nationalism. Sure enough, this becomes a reality in the mid-2030s as a new Indian leader emerges, making Narendra Modi, the former Prime Minister of the 2020s, almost seem moderate and inclusive in comparison. As a result, India turns its focus inward, prioritising domestic production in a bid to secure its own food stability.

- In light of these circumstances, China decides to strengthen its ties with Russia. For several years, Russia's agricultural sector has been catering primarily to Chinese demand. The war in Ukraine, compounded by Western sanctions, prompts Moscow to pivot towards Beijing, leading to a surge in agricultural trade between the two nations. Russian grains are now finding their way to China, a market willing to pay a premium compared to what cash-strapped and less solvent African countries can offer. However, Russia now insists on swift payments for its food exports. Gone are the days when the

Kremlin used food aid as a diplomatic tool to secure loyalty from other nations. Economically, Russia has seen better days. But its agricultural sector remains robust, and Moscow recognises its economic lifeline in Beijing. Chinese investment flows into Siberia surge, targeting the seed industry, infrastructure, and farm equipment. China's technological prowess leads to significant advancements in productivity and a notable rise in yields, especially in areas of Siberia that benefit from the changing climate. China effectively transforms Russian Siberia into its expansive testing ground for precision agriculture, geoengineering, and artificial intelligence innovations.

- On its end, the European Union (EU) faces challenges in securing a foothold in the Chinese market, even though there is sometimes demand and appreciation for its products. Chinese consumers continue to value the quality of the food imported from Europe, and they are confident in the consistent production and trade standards of European suppliers. Although trade volumes might fall short of China's gargantuan requirements, the EU still maintains a presence. However, the EU cannot expand its presence further due to limited additional production capacity back home and internal disagreements among its members on global agricultural trade strategies. Moreover, feeling compelled to follow Washington's lead, the EU hesitates to nurture its economic ties with China, which is now viewed more as a rival than a partner. In the 2020s, the EU wanted to "de-risk" its relations with Beijing. In the 2030s, Washington makes it abundantly clear that it would be risky for the EU to pursue trade with its chief geostrategic competitor. But there seem to be two sets of rules as the U.S. proceeds to capitalise on certain agricultural avenues that European powers left behind, leveraging them to enhance the fading clout of its dollar, which has predominantly become a political instrument.

II • Scenario II – China pursues "healthy and sustainable" consumption, an alliance with the European Union makes sense.

- China stays on the path of development, economic growth, and modernisation. Significant strides are made in bringing people out of poverty in many of the country's once-impoverished rural hinterlands, further adding to the billion-strong consumer base in the early 2020s.

Beijing's official statistics show that by 2030, the country's middle class has grown to encompass 1.2 billion individuals. Remarkably, 150 million of them are considered affluent, with median income levels surpassing even the wealthiest people in the EU. Against this backdrop, China's appetite is growing. While the challenge of feeding its vast population primarily hinges on sheer volume – a task overseen meticulously by the authorities – there is a growing emphasis on quality. And for good reason. The late 2020s witnesses a flurry of health-related controversies that undermine segments of China's agriculture, drawing criticism from societal factions opposing high-intensity and industrial-scale farming practices.

- Meanwhile, European agriculture becomes increasingly sought-after, having struck a balance in terms of social, economic, regional, and environmental sustainability. The storied reputation for the quality of European-produced food finds renewed appeal in the burgeoning Chinese market. The increasing interest can be attributed to strategic geoeconomic decisions made by both sides. Beijing, fully cognizant of its dependence on external sources for food, seeks to decrease its reliance on Brazil's agricultural output and the discretionary benevolence of the United States. Throughout the 2020s, Chinese authorities step up their calls for agricultural and food matters to take a more central role in their collaborative discussions and endeavours with the EU. Brussels is highly attuned to Beijing's overtures, especially since China offers the EU a meaningful platform for agricultural diplomacy where scientific research, environmental concerns, and business interests complement each other harmoniously. Chinese consumers, particularly the younger generation, which is very engaged with the climate issue, are willing to pay a premium for healthy food products that adhere to environmental performance standards, showcasing their dedication to the climate cause. This aligns well with Europe's efforts to reduce carbon in its production system. However, while China gradually embraces the European Green Deal's environmental goals, it approaches them differently, deploying unparalleled financial and technological methods. European agricultural goods, known for their safety and commitment to corporate social responsibility, become increasingly popular in China. The demand for European farm goods in China isn't new, but grows exponentially in the 2030s, making agriculture, food security, and sustainability focal points in Sino-European relations.

- Chinese capital flows back to Europe to support its high-quality agricultural sector. European regulators closely monitor these investments, ensuring they remain transparent and do not result in undue control or ownership over European assets. With an ageing population and reduced consumption, Europe looks to the booming Chinese market as a key destination for its agricultural and food products. European businesses realise that to expand in Asia, they must navigate through China's influence, as Beijing has a significant say in Asian logistics, decision-making, and finances. And to succeed in Asian markets, European companies need to understand and navigate China's provincial system, each of which has its specialty and foreign-country relationship. France, for instance, needs to know which province to collaborate with for entry into markets like the Philippines or Malaysia. Japan and South Korea are exceptions and are not bound by this geopolitical framework.

- The reason Europe continues to make these concessions is because international competition is dwindling. Other agricultural powerhouses (that would otherwise be capable of satisfying a portion of China's needs) cannot rival the quality and environmental standards that European agriculture maintains. China and the EU increasingly partner in trade practices that prioritise both economic and environmental factors (e.g. initiatives for zero deforestation, producer incomes, standards, geographical indications, , etc.). Growing demand allows the EU to increase exports to China, which has become the world's greatest superpower. Some nations express concern that Europe is becoming too intertwined with Beijing—especially as China becomes more self-reliant in sectors that previously gave Beijing no choice but to maintain a cordial understanding with Washington. Brazil has to align with European regulatory standards to maintain its export routes to China for soybeans and corn (crops that Europe cannot produce in abundance). The European Green Deal, launched in 2019, seems to be setting a precedent, with its influence echoing across the globe.

III • Scenario III – China produces more and better and the European Union is left in the dust.

- Here, everything unfolds as in the preceding scenario, up until the mid-2030s. During the second half of the decade, concerns emerge in Europe as agricultural production struggles to keep up with the ever-increasing demands set by strategic initiatives imposed for many years. The EU has failed to equip its agrarian sector with future-ready tools and solutions that ensure consistent yields, especially considering the worsening climate conditions. The EU's slow adoption of advanced varietal selection techniques, particularly new genomic techniques authorised in the EU after heated societal debates in the early 2020s, is causing negative repercussions in the farming sector. Agricultural yields quickly decline. Debates over Europe's trade relationship with China ensue. The question arises: Should Europe continue selling agricultural and food products to China when it faces potential shortages at home? Complicating matters, the cost of pursuing sustainable agriculture is spiralling upward. While the Chinese market appears more capable of bearing these cost increases, Europeans struggle with "greenflation" in food prices — a trend noticeable since the 2020s but intensifying in recent times. The dilemma takes on a geostrategic dimension in the 2030s and 2040s. EU Member States anticipate a likely influx of 100 million migrants by 2050, driven by climate change and rising instability in the neighbouring southern regions. How will Europe accommodate these people? How will they be fed? All of a sudden, Europe shifts its agricultural focus from distant Eastern markets to immediate domestic concerns, and the European Green Deal faces increased scrutiny. While the move to a carbon-neutral and sustainable paradigm is imperative, it comes with fiscal implications and potential geopolitical risks. Those who once criticised Ukraine's accession to the EU now recognise the strategic advantage of having an agricultural titan within their ranks, able to bolster Europe's production capacity and offer productive solutions to the slew of challenges faced by Europe.

- China watches the situation unfold with unease but remains confident in its ability to become carbon-neutral by 2060 and long before the EU. Concurrently, China bolsters its domestic food security with groundbreaking innovations that help reduce agricultural waste, optimise water usage, and ensure the production of nutritious food. When faced with limited options, Chinese consumers know how to live modestly and avoid excess. The proliferation of urban farms supplements food production from rural areas and soothes the anxieties of urban consumers who fear food shortages. The shift towards urban farming and local food production resonates with the younger generation, further fuelling the increasing sense of national pride in the country. China's overarching ambition is clear: autonomy in all areas of essential, strategic, and enduring importance. Chinese agriculture makes significant strides in health and environmental standards, according to the criteria of international standards, which China itself has played a major role in influencing through constant investment over many years in international standardization bodies. This progress enhances the public's appreciation of China's farming practices. Livestock and aquaculture sectors also see remarkable advancements, meeting society's fervent demand for protein. Thus, China manages to rein in the unabating surge in agricultural and food imports that marked the first 30 years of the 21st century. Although China still procures substantial volumes and remains one of the world's top importers, quantities begin to decline in the second half of the 2030s. Trade relations with the EU (China's only exchanges to remain vibrant from 2025 to 2035) wane due to strategic shifts in Europe and China's revitalised domestic capabilities.

- China now enjoys greater flexibility in its global trading pursuits, readily halting commercial interactions when political tensions arise with any nation. Beijing had already done just that in 2020 when it curtailed trade with Australia after Canberra criticised its handling of the Covid-19 pandemic. Recognising the importance of the Chinese market, major agricultural nations tread cautiously. Brazil goes a step further, unreservedly backing China's global policies, keen to maintain harmony with Beijing. Similarly, Russia, South Africa, and India — three major forces in agriculture — continue to hold the Chinese market in high regard. The BRICS nations embrace practices that enhance production and foster environmental sustainability, all while steering clear of the "degrowth" narrative. China had advised them against such a course. While the EU initially had the upper hand in this scenario, its inability to anticipate future developments led it to lose its advantageous position. In contrast, China deftly engaged with Europe to its benefit and strategically distanced itself when it was advantageous. The world has often referenced the "Global South" in an attempt to describe regions aiming to conduct their diplomacy and foreign relations freely, in diverse directions, without being tethered to any specific alignment. In the 2040s, the EU begins to discern the shift from the nebulous "Global South" paradigm to a dominant "China First" framework, where China is the leading power in all things, fiercely guarding its interests, yet remaining an indispensable partner on the global stage. However, Europe finds itself lacking the resources and bandwidth to engage with China. Geographic challenges and its strategic pivot towards veganism leave it vulnerable.

Recommendations

Over and above these imperfect and over-schematic explorations of the future, the following points should be borne in mind for the EU in the short term:

Agriculture is at the heart of the EU's strategic autonomy, not only in terms of food sovereignty, but also in terms of industry and energy. While the Common Agricultural Policy (CAP) must be continually reformed to adapt to different contexts and meet evolving expectations, it cannot be sacrificed in the name of the global and geopolitical reconquest challenges facing the EU.

In this respect, the recently announced rebalancing of the Green Pact is welcome, so that better integration of the economic and industrial components of agriculture can ensure its development. Europe's agricultural and food systems must become more competitive, even in the face of major global transformations and demanding partners like China, which are forcing member states to make robust adjustments.

In other words, the EU must think about its agriculture accepting that it will have to manage both climate and geopolitical upheavals. It will have to fight these environmental and strategic battles head-on, all the more so as the EU's neighbors will inevitably raise vital questions for the agricultural industries of member states and the reasoning to be favored in terms of food security. Ukraine's accession to the EU would change many things, just as greater production and agricultural insecurity in the Mediterranean area would force the EU not to lock itself into a single ecological vision of its domestic agricultural project.

When it comes to China, it would be in the EU's interest to maintain a multi-faceted agricultural and food relationship, and not limit cooperation to trade and climate issues alone. In terms of innovation and science, whether in biotechnology, agro-equipment or logistics, relations are possible and should be encouraged with mutual respect for each other's expectations and concerns. The same applies to the circular economy and the bioeconomy. Agriculture is also one of the main suppliers of renewable energies and bio-sourced materials for the buildings and infrastructures of the future. On the international stage, the EU and China could also take more joint initiatives to promote agricultural development and food security.

Last but not least, a Sino-European discussion on seafood products would be well worth initiating, at a time when the EU intends to strengthen its blue power and China is criticized for its fishing practices in its regional environment or in other seas around the world. Beijing, moreover, excels in aquaculture production, which is set to expand in EU member states, whereas in most cases food deficits stem from chronic under-investment in aquaculture and hence massive purchases of farmed fish from non-EU suppliers.

4.

Decarbonisation and climate negotiations

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Sino-European relations on climate change are highly intricate, shaped by multiple interconnected and often sensitive matters that include: the climate crisis and its ripple effects, global climate talks, international public aid and finance mechanisms, trade issues revolving around essential components for the clean energy transition, and access to cutting-edge technologies that reduce carbon emissions (decarbonisation technologies). In addition, China's stance on these issues often seems to be formulated in response to the United States, with the EU playing second fiddle in Beijing's considerations.

Nevertheless, cooperation in this sector remains pivotal—not just for Europe and China but also for the global community. China is the world's biggest emitter of greenhouse gases and the second largest in cumulative historical emissions behind the U.S. While Beijing has set ambitious goals for reducing China's carbon footprint (pledging to reach peak emissions by 2030 and carbon neutrality by 2060), its efforts on climate change are seen as "highly insufficient" and could lead to a 3°C increase in global temperatures, far exceeding the global target of 1.5° - 2°C set in the Paris Agreement to limit global warming[1]. Over the past decade, China has accounted for over half of global coal consumption, solidifying its position as the world's foremost user of coal. What's more, it continues to expand its production infrastructure, with 106 GW of new coal-fired power capacity, equivalent to 100 large coal-fired power plants, approved for construction in 2022[2].

Over the past 15 years, China has also established itself as a leader in the production and rollout of decarbonising technologies. This has resulted in numerous benefits for China, including economic growth, increased global reliance on Chinese goods, and reduced production costs for these technologies. For example, China now boasts the largest electric vehicle industry in the world. In addition, three out of every four batteries are made in China, giving the country significant control

1 China. (2023, June 6). Climate Action Tracker. https://climateactiontracker.org/countries/china/

2 Reuters. (2023, February 27). China's new coal plant approvals surge in 2022, highest since 2015 -research. *Reuters.* See also the op-ed by Li Shuo, (2023, July 7). Is China really leading the clean energy revolution? Not exactly. *The Guardian.*

over their value chain[3]. China is also the world's largest manufacturer of solar panels, accounting for 80% of photovoltaic (PV) panel production, the exports of which make up almost 7% of China's total trade surplus. The country's prowess in this sector translates to production capacity of 390 GW[4]. China has been the global leader in wind power generation for over a decade, with a total operational capacity of more than 310 GW as of June 2023.[5] In comparison, Europe's capacity is 255 GW[6].

TABLE 1. Comparison of manufacturing costs for a crystalline silicon module (2022)

Country/Region	Total cost of a module with a price tag of $37/kg for poly-silicon:
China	$0.30/W
United States	$0.35/W
European Union	$0.36/W

▲ *Source: Will new PV manufacturing policies in the United States, India and the European Union create global PV supply diversification? – Analysis. (2022, December). IEA.*

3 Leplâtre, S. (2023, April 18). China leads the charge in electric vehicles. *Le Monde*. Mazumdaru, S. (2023, September 20). EV batteries: Can the West catch up with China? DW.
4 *Solar PV Global Supply Chains – Analysis*. (2022, July). IEA.
5 Mei, D., Weil, M., Prasad, S., O'Malia, K., and Behrsin, I. (2023, June). A Race to the Top China 2023: China's quest for energy security drives wind and solar development. Global Energy Monitor.
6 Maguire, G. (2023, March 1). China widens renewable energy supply lead with wind power push. *Reuters*. WindEurope. (2023, February 28). Wind Energy in Europe: 2022 Statistics and the outlook for 2023-2027.

TABLE 2. A few examples of China's central role in the global energy system

Sector	Global share, year
GDP	18% (2023)
Population	17.7% (2023)
Coal consumption	54% (2021)
Greenhouse gas emissions	27% (2021)
Battery production	75% (2022)
Photovoltaic solar panel production	80% (2022)

▲ Sources: Statista, IEA

Beijing also carries significant diplomatic clout in global climate talks, wielding considerable leverage in negotiations, especially with developing nations[7]. Its partnership with the U.S. was instrumental to the success of COP21 in 2015[8]. More recently, China's leadership during the COP15 discussions on biodiversity and its adept negotiation capabilities culminated in signing the Global Biodiversity Framework in Montreal in late 2022[9]. Additionally, China continues to strengthen its climate diplomacy efforts by establishing new multilateral banks, such as the Asian Infrastructure Investment Bank (AIIB)[10].

Under these circumstances, what stance should the EU adopt vis-à-vis Beijing? It seems clear that China only has eyes for Washington and regards Brussels as a secondary player[11]. In addition, the China-EU

7 Blaxekjær, L. Ø., & Nielsen, T. (2014). Mapping the narrative positions of new political groups under the UNFCCC. *Climate Policy*, 15(6), 751–766. Blaxekjær, L. Ø., Lahn, B., et al. (2020). The narrative position of the Like-Minded Developing Countries in global climate negotiations. In Klock C. et al. *Coalitions in the Climate Change Negotiations*, London: Routledge. pp. 113–135.

8 Eckersley, R. (2020). Rethinking leadership: understanding the roles of the US and China in the negotiation of the Paris Agreement. *European Journal of International Relations*, 26(4), 1178–1202.

9 Lo, J. (2022, December 19). Cop15 global nature deal passes despite DR Congo's objection. *Climate Home News.*

10 Ng, E. (2022, October 27). Climate change: majority of China-backed development bank AIIB's financing to go to mitigation and adaptation by 2025. *South China Morning Post.*

11 Schuman, M. (2022, November 21). Where U.S.-China competition leaves climate change. *The Atlantic.*

relationship on climate matters is not devoid of strain – as witnessed when Beijing abruptly halted the signing of a climate agreement with the EU in 2017, making its approval contingent on obtaining "market economy status." However, the deal was eventually inked the following year. The EU, in turn, has tried more than once to adopt a more assertive stance towards China, albeit with little to show for it[12]. But despite some of these challenges, climate change could provide a conduit to foster closer ties between China and the EU.

The three scenarios for Europe that we will map out shortly hinge on multiple factors, including:

- **The trajectory of U.S. climate policies**, especially if Donald Trump returns to the White House in 2024 (or if another climate-sceptical candidate wins the election). This would isolate China and the EU on the global climate stage, compelling them to collaborate more closely on climate issues. But such a rapprochement would likely be perceived as reluctant or contrived and could pose certain risks, predominantly for Europe[13];
- **Changes in political leadership across Europe**, especially if enough countries witness the rise of political parties intent on curtailing their climate commitments – as observed in Sweden[14]. This would make it challenging to reach a consensus and unify positions regarding China among European capitals and the European Commission;
- **The economic slowdown experienced by several European countries**, which could lead to a pause in climate initiatives (as already called for by the conservative members of the European Parliament

12 Harvey, F., & Vidal, J. (2011, December 9). Durban COP17: Connie Hedegaard puts pressure on China, US and India. *The Guardian*. Harvey, F. (2022, November 18). EU reversal of stance on loss and damage turns tables on China at Cop27. *The Guardian*.

13 While Trump was president, China made every effort to keep channels of communication open with other major players engaged in fighting climate change, particularly the EU and Canada. Although this effectively isolated the U.S. by keeping Washington out of the loop on these discussions, it allowed some major carbon-emitting countries to keep the climate conversation going. Mathiesen, K. (2018, September 13). Let down by Trump on climate, China goes around him in California. *Climate Home News*.

14 Hivert, A. (2023, April 6). Swedish government criticized for abandoning climate targets. *Le Monde*.

and certain countries[15]) and a reduction in resources dedicated to international aid;
- **The future trajectory of China's economy** and the central government's ability to rein in the advancement of local carbon-intensive projects, notably the construction of new coal-fired power plants;
- **Potential export restrictions China might impose on essential components** for the energy transition.

I • Scenario I – The EU draws closer to China (but strategically)

This could happen if relations were to thaw between China and the West. Eager to bolster its ties with Brussels, China might choose to recalibrate its alliances, putting some on the back burner (e.g. Russia) to make way for new economic agreements with the EU. For China, the allure would likely centre more on trade opportunities than environmental concerns. Beijing could want to negotiate access to its carbon-free components and technologies in exchange for adjustments to the EU's Carbon Border Adjustment Mechanism (CBAM)[16]. Interestingly, Beijing has recently been hinting at curbing imports of certain goods, notably the components for solar panels—a linchpin of Europe's energy transition[17]. European efforts to draw closer to China would undoubtedly be seen as a slap in the face by Washington and could stir the pot in transatlantic relations.

RECOMMENDATIONS FOR THE EUROPEAN UNION

An alignment of this nature could disproportionately favour Beijing over European nations, presenting more potential risks than opportunities for the latter. It's therefore of utmost importance for the EU to adopt a resolute stance, demanding that China's contribution to the global fight

15 Abnett, K. (2023, May 25). Europe hits resistance in race to finalise green laws. *Reuters.*
16 Bermingham, F. (2023, June 6). China berates EU at World Trade Organization for policies it calls unfair. *South China Morning Post.*
17 Jucca, L. (2023, February 3). China ban would slow, not halt, Western solar push. *Reuters.*

on climate change be proportional to its economic heft and yearly emissions. To achieve this, the EU should:

- Engage developing nations, especially those dissatisfied with China's overly conservative stances (e.g. the highly influential Small Island Developing States). Use this alignment to negotiate a change in China's status at the United Nations, ensuring that it is stripped of its "developing country" designation and that it contributes its fair share to global climate initiatives;
- Ensure uninterrupted access to solar panel components and other essential products while also investing in the EU's energy independence;
- Exercise caution when considering technological partnerships or trade policies that could place European companies at a disadvantage, particularly those businesses bound by stricter regulations and higher labour costs[18];
- Exert pressure on China to heighten its climate ambitions, pushing for swift, irreversible reductions in coal consumption and advocating for a more transparent international commitment—like unambiguous calls to end the use of fossil fuels[19];
- Promote joint Sino-European international aid initiatives, perhaps by involving Beijing in programmes like the Just Energy Transition Partnership (JETP) to speed up the transition to sustainable energy in emerging countries.

Last but not least, outside of climate considerations, the EU must stand firm on its political positions and avoid looking like a subordinate to Beijing.

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18 The aluminium sector, for example, has expressed concerns about the CBAM: Dempsey, H., & Hancock, A. (2023, July 9). Aluminium companies complain about EU carbon border tax loophole. *Financial Times*.

19 The EU could, for example, encourage Beijing to sign the High Ambition Coalition's open letter on ending the fossil fuel era, which has already been signed by 17 countries (including 7 European countries) and the European Commission: End the Fossil Fuel Era & Move Towards a Clean Energy World. (2023, July 14). *The High Ambition Coalition*. https://www.highambitioncoalition.org/statements/cochair-summary-april-2021-9n7c5-z7kxl-733k4-k2c9b-hwydy-kzes3-35pxh-5sj26?stream=top

II • Scenario II – The EU maintains current relations with China and the U.S. and strengthens support for developing countries

Given the prevailing rivalries among major powers, the EU might deem it wiser to step up its climate policy and diplomacy efforts rather than seek closer ties with China or the U.S. Here, the EU and its members would continue and expand the numerous initiatives undertaken to support climate action in developing countries worldwide[20]. This leading role as a donor would enable the EU to assert its climate leadership in the face of China, which has so far failed to meet its commitments of $3.1 billion per year[21]. This is not to say that China won't rapidly emerge as a significant player in international climate finance. If it does, competition in global climate cooperation will undoubtedly ensue.

RECOMMENDATIONS FOR THE EUROPEAN UNION

This scenario is close to the status quo but would involve the EU enhancing its climate diplomacy to increase the visibility of its actions and not lose its international sway to Beijing. The EU must steadfastly maintain a gold standard in its efforts to mitigate climate change, improving its global standing and credibility—especially compared to the United States and China. By doing so, the EU would be acknowledged as an indispensable international voice, obviating the need for partnerships

20 Examples: 1) at the EU level: European Commission. International climate finance. Climate Action. https://climate.ec.europa.eu/eu-action/international-action-climate-change/international-climate-finance_en; 2) in Germany increases climate finance for developing and emerging economies – 2021 commitments totalled 5.34 billion euros. (2022, October 20). Federal Ministry for Economic Cooperation and Development. https://www.bmz.de/en/news/press-releases/germany-increases-climate-finance-in-2021-125994; 3) in France: Ministère de l'Europe et des Affaires étrangères. Financing: a key issue in the fight against climate change. https://www.diplomatie.gouv.fr/en/french-foreign-policy/climate-and-environment/the-fight-against-climate-change/financing-the-fight-against/

21 Note that estimates of China's international climate aid vary significantly. See "Kitano N., Miyabayashi Y., (2020). Estimating China's foreign Aid: 2019-2020 Preliminary figures. JICA Ogata Sadako Research Institute for Peace and Development., and Tsang B., Schape B., Hackbarth A. (2023, April 18). Follow the money: Chinese climate-related finance to the Global South. E3G.

with other global powers. To get there, the EU should:

- Draw up and steer international trade policies incorporating climate and environmental considerations, notably within the World Trade Organization (WTO). Use mechanisms like the Coalition of Trade Ministers on Climate[22] or join the Agreement on Climate Change, Trade and Sustainability (ACCTS)[23] to impose taxes on environmentally harmful products and safeguard the CBAM, especially against challenges from China at the WTO;
- Bolster the European narrative to accurately reflect efforts made on the ground. Meanwhile, strengthen and diversify initiatives that improve the coordination and visibility of European undertakings in countries around the world, such as "Team Europe" initiatives that allow Member States to combine efforts and secure broader EU support[24], thus deepening ties with target nations;
- Speed up the establishment of partnerships with development banks, like the AIIB or the New Development Bank, to pre-empt potentially overlapping projects;
- Cement the EU's stance on climate finance through monetary contributions (e.g., Green Climate Fund, anticipated Loss and Damage funds) and champion reforms in Bretton Woods institutions, perhaps through avenues like the Bridgetown Initiative or the G20[25];
- Implement tailored multilateral projects for specific countries, drawing inspiration from the JETP blueprint. Replicate such models with other countries (e.g., India) and new sectors (e.g., biodiversity).

22 Members | Coalition of Trade Ministers on Climate. COTMC. https://www.tradeministersonclimate.org/members

23 Voituriez T., Cremers K., (2023, June 22). Is there a case for the EU to join the Agreement on Climate Change, Trade and Sustainability (ACCTS)?. IDDRI.

24 European Commission. Team Europe Initiatives. International Partnerships. https://international-partnerships.ec.europa.eu/policies/team-europe-initiatives_en

25 Barbados calls for finance reform to fight climate change. (2023, January 13). World Economic Forum. https://www.weforum.org/agenda/2023/01/barbados-bridgetown-initiative-climate-change/

III • Scenario III – The EU strengthens its partnership with the U.S.

This scenario is only conceivable if the U.S. ushers in an administration ardently committed to climate issues or in the event of Chinese export restrictions and a protracted cooling of bilateral relations with China, which would prompt the EU to seek alternative suppliers. While this would consolidate the positions of various partners towards China, it would also amplify Beijing's adversarial posture, underpinned by its anti-Western rhetoric.

This strategic alliance of liberal democracies, anchored in the mutual interests of both powers and underscored by a history of collaborative efforts[26], would likely have the implicit objective of strengthening the stance of liberal democracies against China. But it also runs the risk of exacerbating tensions between, on the one hand, northern countries centred around the U.S.-Europe duo and its G7 allies, and on the other hand, southern countries led by China as well as India, Russia, and the Gulf States. Such a partnership would also be somewhat fragile since it would be subject to reassessment every four years during the American elections, with policy reversals potentially undoing the progress made in previous years.

RECOMMENDATIONS FOR THE EUROPEAN UNION

Within the framework of such a partnership, the EU would be wise to:

- Avoid creating long-term dependence on American exports of low-carbon technologies. The Inflation Reduction Act (IRA) serves as a poignant reminder of the U.S. strategy to prioritise its domestic economy, even at the potential detriment of its partners and allies;
- Leverage this alliance to raise climate ambitions among G7 nations and solidify their stance against China on critical technologies for a sustainable energy transition, including batteries, solar innovations, and hydrogen-based solutions. Concurrently, use the G7 Climate Club to champion global climate actions and ratchet up international aspi-

26 Illustrated, for example, by U.S. exports of liquefied natural gas (LNG) to Europe after Russia cut the flow of gas to European countries following the invasion of Ukraine.

rations[27];

- Intensify collaboration with the Global South and increase financial contributions for climate change mitigation (especially for mechanisms like the Green Climate Fund and the Loss and Damage funds) to bridge the North-South divide;
- Enhance the pace and scale of European investment policies in energy transition (to counteract measures like the IRA) to foster the creation of an industrial bedrock in sectors like solar energy and batteries. This approach would position Europe as a more attractive investment destination for businesses around the world.

Conclusion

Irrespective of any political changes to come in the U.S. and China, it behoves Europe to prioritise the following three recommendations:

- **Strengthen Strategic Autonomy.** Europe's dependence on China for its clean energy transition represents a strategic vulnerability and poses major risks. Europe must urgently speed up the adoption of reindustrialisation strategies to cultivate a competitive and largely autonomous low-carbon industrial and energy landscape, drawing inspiration from the American IRA model that has proven its ability to spur investments by substantially cutting production costs. Efforts in this area remain insufficient for Europe to become competitive. For instance, the International Energy Agency (IEA) believes that the IRA should make the production costs of crystalline silicon photovoltaic modules as competitive in the U.S. as in China, closing the gap shown in the table above and pulling even further ahead of the EU, where the costs remain the highest.
- **Uphold robust climate commitments**—encompassing mitigation and adaptation—to preserve global leadership in climate matters **and persistently champion decarbonisation efforts** within the framework of the European Green Deal.
- **Maintain a strong commitment to international climate aid efforts,** optimising coordination between programmes and initiatives led by

27 Erbach, G., & Scalamandrè, C. (2023). G7 Climate Club. European Parliamentary Research Service. https://www.europarl.europa.eu/RegData/etudes/ATAG/2023/739385/EPRS_ATA(2023)739385_EN.pdf

Brussels and those managed by individual European countries. **Speed up Bretton Woods system reforms**, supporting initiatives like Bridgetown to improve financial support mechanisms for nations impacted by natural disasters.

5.

Rebalancing trade dependency on China: de-risking scenarios by 2035

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The decoupling of the technology sector between the US and China increases the risk for third countries to be on the receiving end of coercive trade practices. The increasing weaponisation of trade policy has prompted the EU to develop a framework for economic security that increases the resilience of its supply chains. Reducing over-reliance on China is one pillar of this de-risking strategy. In 2022, 21% of EU merchandise imports originated in China. Dependence on Chinese inputs in some value chains is even more significant.[1] For example, up to 40% of active pharmaceutical ingredients are from China. Alternative suppliers, like India, are often themselves highly dependent on Chinese components.[2]

Nevertheless the EU can also leverage trade dependencies to project its values and power, as the Chinese economic model remains highly dependent on Western markets.[3] For example, 11% of Chinese merchandise imports come from the EU. Access to EU technologies becomes even more crucial for China as the US increasingly restricts access.[4] China is also almost twice as dependent on the EU market for its exports: 16% of Chinese merchandise exports are destined for the EU, while only 9% of EU merchandise exports go to China.[5] This asymmetry in market access suggests that the EU should broaden its de-risking strategy to include the strategic management of interdependence.

De-risking involves a trade-off between security and efficiency. Global value chains have reduced the cost of production and attempts to secure supply chains through reshoring and friendshoring will increase prices for consumers and businesses. Policymakers seeking to de-risk must also consider the these economic and political costs of inflation. Therefore, setting the proper criteria to determine which value chains are overly dependent requires focusing on critical vulnerabilities.

1 Guinea, O., & Sharma, V. (2022, April). Should the EU pursue a strategic ginseng policy? Trade dependency in the brave new world of geopolitics. ECIPE. https://ecipe.org/publications/trade-dependency-in-the-brave-new-world-of-geopolitics

2 Marchais, I. (2023, March). For a secure supply of pharmaceutical products - *Policy Paper n°289*. Institut Jacques Delors.

3 Iglesias, S. G., & Matthes, J. (2023, March). China's dependence on the West for imports and technologies. German Economic Institute (IW). https://www.iwkoeln.de/en/studies/simon-gerards-iglesias-juergen-matthes-chinas-dependence-on-the-west-for-imports-and-technologies.html

4 UN COMTRADE.

5 UN COMTRADE.

The European Commission has established three criteria to assess critical import dependency: the importance of European demand, the concentration of production and substitutability. According to this metric, the EU currently has an excessive dependence on 137 strategic products, representing 6% of the value of the EU's total imports, while 34 imported products, or 0.6% of total imports, have no easy substitutes.[6] The EU imports 52% of these strategic products from China.[7] However, it is unclear whether these imports come from Chinese companies or European subsidiaries based in China reimporting to the EU.

But it is not sufficient to only focus on critical trade dependencies. Non-critical trade dependencies can and frequently have been used as leverage to achieve political aims. In fact, restricting access to its market has in the recent past been the most commonly used instrument by China to exercise economic power, e.g. against Norway, South Korea, Australia, and Lithuania.

Applying dependency thresholds (see Figure 1 below) therefore can provide a useful lens to assess the trade dependencies across a wider range of products. We define a dependency threshold as the point at which the trade of a product with a partner country surpasses a specified level of overall trade of that product, thus signifying a notable reliance or concentration that may warrant further analysis.

In 2022, for 46% of products imported in the EU, which together account for 91% of the value of EU imports from China, or 19% of the value of all EU imports, the EU imports at least 20% from China. Conversely, for 49% of products imported in China, representing 81% of the value of China's imports from the EU, or 8% of the value of all Chinese imports, at least 20% are imported from the EU. This indicates a greater reliance of the EU for imports from China at the 20% threshold that is asymmetric by a factor of two compared to the reliance of China on EU imports. As we escalate the dependency threshold to 50%, trade interdependencies narrow but remain significant and asymmetric. The EU's imports from China within this band comprise 20% of all products, which still

6 European Commission. (2021). Commission Staff Working Document (2021)352. https://commission.europa.eu/system/files/2021-05/swd-strategic-dependencies-capacities_en.pdf

7 Ibid.

represent 64% of the value of EU imports from China and 13% of the value of the EU total imports. In contrast, the same threshold for China's imports from the EU includes 21% of products, or 42% of the value of imports from the EU and only 4% of the value of all Chinese imports. At the 50% threshold the EU is therefore three time more dependent on China for its imports than vice versa.

Evaluating trade interdependencies at the 80% threshold shows a concentrated reliance on specific products, which nevertheless still represent significant value. For the EU, 5% of products have this high degree of import dependence on China, which represent 22% of the value of all imports from China, and 5% of the value of the EU's total imports. Conversely, for 8% of the products China imports, 80% originate in the EU, which represents 7% of the value of its imports from the EU, or 0.8% of the value of China's overall imports from the EU. EU import dependency at this threshold is there almost seven times higher than Chinese import dependence on the EU.

It is noteworthy that the higher the dependency threshold, the greater the asymmetry between China and the EU, which could potentially be exploited by China in the future.

However, on the flip side, market power is usually exercised through restricting (or threatening to restrict) imports, not exports, unless there is a near-monopoly position of the exporter. And notably, China is significantly more dependent on access to the EU market than vice versa.

For example, for 7% of products more than 20% of EU exports are destined for China, representing 39% of the value of the EU's exports to China, and 3% of the value of all EU exports. In comparison, China displays a higher dependency on the EU market: for 19% of products at least 20% of Chinese exports are destined for the EU, which together account for 49% of the value of China's exports to the EU, or 8% of the value of all Chinese exports. This suggests that China is almost three times more reliant on the EU as an export destination at this threshold than vice versa.

At the 50% dependency threshold, the EU's export dependency on China contracts to 1.2% of products, which together account for 7% of the value of EU exports to China and 0.6% of the value of all EU exports. For 2% of Chinese products at least 50% of their exports are destined for the EU, which represents 8% of the value of China's exports to the EU, or 1% of the value of China's total exports. China is therefore almost twice as dependent on the EU as an export destination.

Lastly, only 0.25% of EU products reach a 80% dependency threshold for exports to China, accounting for 1.2% of the value of EU exports to China, or 0.1% of the value of all EU exports. For China, only 0.6% of products have an export dependency on the EU of at least 80%, which represents 1.4% of the value of Chinese exports to the EU, or 0.22% of the value of all Chinese exports. However, this is also about twice as high as the EU export dependency at this threshold.

These figures not only underscore the differing nature of dependencies on imports versus exports between the EU and China but also reflect broader economic strategies and vulnerabilities. The EU's import profile from China suggests an overall higher reliance on China, while China's export profile in particular indicates a strong reliance on the EU market. This dichotomy has strategic implications, with the EU potentially wielding greater leverage over China in areas where Chinese exporters are highly reliant on the European market.

FIGURE 1. Levels of trade dependency for goods between the EU and China in 2022 according to different thresholds of dependence

EU import dependency on China

Dependency threshold	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
% of products	58	46	36	27	20	14	9	5	2	0.1
% of value of EU imports from China	96	91	94	74	64	48	30	22	12	0
% of value of all EU imports	20	19	17	15	13	10	6	5	2	0

Example: For 58% of all products (at the HS6 level), the EU imports at least 10% from China, which represents 96% of EU goods imports from China and 20% of all EU goods imports.

Source: COMTRADE

EU export dependency on China

Dependency threshold	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
% of products	20	7	3	2	1.2	0.9	0.5	0.3	0.1	0
% of value of EU exports to China	70	39	19	13	7	4	3	1.2	0.4	0
% of value of all EU exports	6	3	2	1.1	0.6	0.3	0.2	0.1	0.04	0

Example: For 20% of all products (at the HS6 level), the EU exports at least 10% to China, which represents 70% of EU goods exports to China and 6% of all EU goods exports.

Source: COMTRADE

Chinese import dependency on EU

Dependency threshold	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
% of products	62	49	37	29	21	16	11	8	5	1
% of value of Chinese imports from EU	89	81	68	55	42	27	10	7	3	0.1
% of value of all Chinese imports	9	8	7	6	4	3	1.1	0.8	0.4	0.01

Example: For 62% of all products (at the HS6 level), China imports at least 10% from the EU, which represents 89% of Chinese goods imports from the EU and 9% of all Chinese goods imports.

Source: COMTRADE

Chinese export dependency on EU

Dependency threshold	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
% of products	42	19	8	4	2	1.3	0.9	0.6	0.4	0.1
% of value of Chinese exports to EU	91	49	22	10	8	3	2	1.4	0.8	0
% of value of all Chinese exports	14	8	4	2	1	0.4	0.3	0.2	0.1	0

Example: For 42% of all products (at the HS6 level), China exports at least 10% to the EU, which represents 91% of Chinese goods exports to the EU and 14% of all Chinese goods exports.

Source: COMTRADE

While the EU is committed to de-risking, with a combination of industrial policy and trade diversification providing targets and incentives for European companies, the risk of further fragmentation of the global trade landscape over the next decade will thus require a high degree of adaptability. The EU remains committed to a rules-based international system. Still, the modalities of the US-China confrontation will largely determine the reorganisation of global trade, with four potential scenarios in the spotlight. In particular, the scope of de-risking (limited to the technology sector or extended more widely), the speed (the degree by which the US feels threatened by China's initiatives) and the mode (orderly or fragmented and coercive for third countries if export restrictions escalate) will determine the trend from a scenario of renewed cooperation to an extreme scenario of open conflict.

I • Scenario 1 – Renewed cooperation

Two decades of WTO membership and integration into global value chains have allowed China to multiply its GDP by a factor of thirteen. Xi Jinping, actively promoting the Chinese development model, wants to continue to reap the benefits of globalisation. Domestic consumption has not recovered as expected after the pandemic. The Chinese economy remains highly dependent on external demand. Despite greater regional integration in Southeast Asia, access to the European market remains strategically important. Xi is keeping the Chinese market relatively open to attract foreign investment. He is making unilateral commitments on level playing field issues addressed bilaterally in the Comprehensive Agreement on Investment (CAI).

A second Biden presidency (2024-2028) makes it possible to reform the Appellate Body of the WTO dispute settlement system and to engage the US, China, the EU and other partners in mini-lateral fora, notably on industrial subsidy transparency. A temporary framework on subsidies for the energy transition will be negotiated to avoid an escalation of power rivalry.

The West is also facing persistent inflationary pressures. The search for the most profitable production location precedes national security concerns. There is little diversification of supply away from the Chinese market. Despite the slowdown in growth rates, absolute flows between China and the West continue to increase gradually.

POLICY IMPLICATIONS FOR THE EU

The EU remains open to trade with China as long as there is reciprocity and a level playing field. Imports into the single market are linked to new investments in the EU. Where China has gained a technological lead via unfair competition, it has to commit to transferring technology (e.g., for components for electric car batteries, solar panels, and critical mineral processing). The EU may also actively use anti-dumping measures and autonomous trade defence instruments (such as control of foreign subsidies, reciprocity in public procurement, and anti-coercion) to gain better access to the Chinese market.

II • Scenario 2 – Managed coexistence

The structural problems of the Chinese economy are causing a gradual slowdown (ongoing real estate crisis, local government debt, significant youth unemployment, ageing society and lack of healthcare infrastructure, limits to the capital-intensive growth model, focus on state-owned enterprises limiting improvements in productivity and innovation capacity). This slowdown in the Chinese economy limits the threat of the Chinese economy overtaking the US as the leading technological and economic power. China is compensating for the hit from the US semiconductor export ban and outbound investment control as well as its domestic difficulties in scaling up its advanced chip production by leveraging its critical mineral processing capacity and monopoly position in producing a number of green technologies.

US-China decoupling continues but is limited to de-risking in the technology sector, especially disruptive, green, and military technologies. The US seeks a transatlantic rapprochement, and Washington and Brussels manage to coordinate their economic security objectives. A large bloc of non-aligned countries is navigating between the competing regulatory spaces, and South-South economic integration is increasing. Absolute flows are flat, and relative flows to and from China are slowly declining. But geopolitical risk is becoming a more significant factor in investment calculations. China remains committed to its official goal of "self-sufficiency". This limited cooperative attitude requires European companies to limit their overdependence on Chinese imports. Existing European production in China remains outside high-risk sectors and may even increase investment. But new entrants are limited.

POLICY IMPLICATIONS FOR THE EU

European companies are engaging in orderly de-risking in high-risk sectors or for specific products. De-risking incentives are built into investment guarantees, and there are reporting requirements at the company level.

The EU is extending its Green Industrial Plan to other technologies. However, ratifying new FTAs and ad hoc agreements is a higher priority to secure access to raw materials and accelerate the diversification of supply from China.

Europeans seek to avoid being trapped in a Western bloc by looking for specific niches where cooperation with China can mutually benefit. The Europeans are finding areas where the Chinese can be convinced that the cost of cooperation will be lower than the cost of non-cooperation (e.g. BioNTech vaccination would have cost USD 40 billion vs USD 250 billion of useless Covid testing by 2022). Three areas are commonly mentioned for potential cooperation with China: health/environment/agriculture. So far, apart from China's commitment to biodiversity, there is little evidence of successful cooperation. The energy transition constitutes ground for confrontation, with an increased risk of economic coercion. Europeans must anticipate the threat that China can impose export restrictions on components of green technologies (wafers for solar panels, components of mineral processing technologies...) and cause inflationary prices for targeted countries or companies.

The EU can look for areas of common interest with China vis-à-vis the US. A relative de-dollarisation of their respective economies could limit the risk of extraterritorial US coercion. The EU and China could also pressure the US to adopt regional banking regulations to avoid a future global credit crunch.

III • Scenario 3 – Accelerated fragmentation

Chinese consumption is boosted by the investment of private savings accumulated during the pandemic. The subsequent recovery of the Chinese economy allows for increased investment in technological innovation and productivity gains. The definition of "critical sectors" is broadened considerably. For example, China significantly diversifies its food imports away from the US.

The US moves from de-risking to a broader decoupling strategy. A new Republican administration in 2024 prioritises an aggressive "America First" policy focused on industrial policy (with subsidy races and more local content requirements) and strains the global trading system. Coordination with European allies is complex. There is an escalation of retaliatory measures between the US and China. The alignment of countries in the Global South is based on security guarantees from one or the other power.

For European companies, uncertainty overcomes the relative attractiveness of the Chinese market. Economic security criteria trump short-term financial benefits. Geopolitical risk and security guarantees drive most new investment. This leads to significant reshoring and friendshoring of existing production in China. The absolute decline in trade flows accelerates over time and beyond the technological sector.

POLICY IMPLICATIONS FOR THE EU

EU businesses are being forced to engage in a disorderly de-risking across many sectors of the economy. Governments add a more active intervention with more regulatory constraints to their incentives for de-risking. EU de-risking also involves deviations from WTO rules.

EU multinationals develop local R&D "in China for China" and the EU gives preferential treatment to exports to China from European multinationals present in China that re-import part of their value chain back to the EU (representing 50% of the EU trade deficit with China).

However, European multinationals continue to distinguish between the Chinese private sector and the state-owned sector, between the central government in Beijing and local public authorities, and between the

Chinese government and its people, especially the youth. EU multinationals continue to find opportunities where Chinese private companies need productivity solutions (e.g. industrial software) as an alternative to Chinese reliance on US offerings. European companies are developing a "China +1" strategy through joint ventures in Southeast Asia with private Chinese entrepreneurs keen to de-risk their newly acquired China exposure.

IV • Scenario 4 – An open conflict

Xi Jinping remains committed to taking control of Taiwan. He opts for a gradual economic embargo rather than a military invasion. But if there is no agreement between China and the US on semiconductor exports, war is hard to avoid. Taiwan produces 65% of the world's semiconductors and 90% of advanced chips. Export restrictions on Taiwanese semiconductors hit countries with limited domestic capacity of production. This leads to semiconductor supply shocks and significant inflation in all sectors of the Western economy. There is not just a technological plateau but a sudden decline in growth, with major disruptions in global value chains and the need for rapid reconfiguration.

The military confrontation quickly draws in other partners, forcing them to choose sides. With 48% of global trade logistics passing through the China-Formosa Strait, global trade logistics are severely affected. A rapid militarisation of economic interdependence shakes all value chains.

POLICY IMPLICATIONS FOR THE EU

While imposing a post-facto ban on companies involved in supplying military spare parts to Russia, the EU is pre-emptively announcing severe trade sanctions against China in the event of aggression against Taiwan. Identifying sectors and products to be targeted must be prepared well in advance, as despite current posturing, in the event of Chinese military aggression against Taiwan, the Europeans will most likely align themselves fully with the US.

Conclusion

These scenarios are internally coherent narratives combining geopolitical, macroeconomic and supply chain factors. Other combinations of these factors are, of course, possible. It will remain necessary for the EU to oscillate between cooperation, competition, and coercion. Recent trends point to a negative shift between the scenarios, from coexistence to fragmentation, with a growing risk of retaliation and escalation spirals. However, China may also accelerate its isolation from the West before reaching a trough, which could demonstrate the downsides of isolationist policies. The EU should continue to emphasise the economic costs to China of such choices and be ready for renewed cooperation at the time of China's reopening.

6.

The erosion of the WTO's multilateral regulatory framework and emergence of alternative spaces for regulating international trade

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The World Trade Organization (WTO) has quietly wrestled with an unprecedented crisis for the past three years, prompting a profound reassessment of the framework underpinning our global economic exchanges. Driven by simmering frustration over China and resentment over trade liberalisation, the United States has chosen to stymie the functioning of the organisation's dispute settlement mechanism (DSM), deeming it overly sluggish and supranational. In doing so, Washington has stripped the WTO of its ability (unique among international organisations) to enforce a legally binding set of multilateral rules, thereby paving the way for further weakening of the multilateral regulatory framework.

The WTO's regulatory framework and its merits

While the tariff increases during the Trump administration gained significant media attention, they were just one aspect of the broader decline in the international economic regulatory framework. In the 21st century, the central focus has shifted away from tariff barriers. The U.S. and Europe have become increasingly frustrated with Chinese bending of the WTO spirit while over the past decade the new commercial giant continued to decrease its tariff rates. The disastrous effects of Brexit on the British economy, which still enjoys tariff-free trade with the rest of Europe, serve as another stark illustration.

Regulatory considerations have become pivotal in shaping international trade in the current age of highly advanced technological goods, characterised by intricately interwoven global value chains. As public and consumer concerns related to product safety, environmental sustainability, and data privacy continue to grow, governments will likely place even greater emphasis on non-tariff measures. The WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT), have historically focused on regulating tariff protections for domestic producers. Today, the majority of trade barriers are related to safety standards and/or consumer preferences., and this trend will likely continue in the future.

A well-functioning WTO provides an international framework for regulatory issues, with the aim of discouraging predatory behaviour and arbitrary discrimination[1]. The WTO actively shapes and guides international policies related

1 In this context, "predatory behaviours" refer to situations where one entity seeks to profit by exploiting the existing value created by another (i.e. without adding any real value themselves).

to industrial practices, intellectual property rights, and transparency, providing a basis for creating specific regulations in these areas. While sometimes criticised as interference, this regulatory blueprint ensures that discriminatory actions against foreign products or entities are based on credible evidence and sound reasoning, ideally with scientific validation and international recognition and acceptance.

Any hopes that this situation might have been only temporary, attributable to the idiosyncrasies of an American President, have been dashed. Even after a change in administration in Washington, the U.S. is not back on the path of compliance with the WTO's cardinal principles. Washington's decisive industrialist and mercantilist shift, enshrined by the Inflation Reduction Act of 2022, has unequivocally reinforced the existing fracture already laid bare by the dwindling U.S. commitment to the institution's headquarters in Geneva. Meanwhile, China has strengthened the aspects of its economic model most at odds with the principles espoused by the WTO. The country has redoubled its efforts to prop up strategically important businesses through subsidies and has further consolidated the party-state's grip on the entire economy.
It seems clear that the WTO's dysfunction is causing its rules, practices, and principles to gradually become less effective, as experts had feared[2].

Europe has failed to prevent the breakdown of this cherished international ordoliberal trade order, founded on the principle of law prevailing over force. Worse still, even though a reform and revitalisation of the WTO have long been among the top priorities of the EU's trade policy, the myriad of official discussions spearheaded by the EU have been at a standstill since the end of 2019. Overall, the European approach does not appear to have achieved resounding success. Meanwhile, the need for international regulatory cooperation is growing ever more urgent in areas such as the environment, health, food, and digital technologies.
It therefore seems like an opportune time to review the European approach to international trade and cooperation. To this end, below are three possible scenarios, each providing instructive insights.

2 Hoekman, B. M., & Mavroidis, P. C. (2020). Preventing the Bad from Getting Worse: The End of the World (Trade Organization) As We Know It?. European University Institute, EUI Working Paper RSCAS 2020/06.

I • The status quo scenario

The first scenario involves a continuation of prevailing trends. In other words, the gradual demise and slow decline in the effectiveness of the WTO's multilateral framework due to the relentless pursuit of self-interested, mercantilist economic policies by major international players. As suggested by the active level of engagement of China, the US and the EU in their respective bilateral negotiations, this situation is likely to result in the coexistence of multiple non-exclusive regulatory frameworks catering to the major economies. The emergence of this new regulatory landscape would unfold gradually through the implementation of individual regulations by different countries and the establishment of bilateral and regional agreements focusing on specific sectors or themes. This would result in a "noodle bowl" effect, a well-known concept in international trade literature referring to the intricate snarl of standards and procedures arising from a proliferation of overlapping regulatory frameworks.

The challenges and conflicts arising from the coexistence of multiple regulatory frameworks would almost certainly outweigh any potential benefits and ultimately harm global well-being. This is especially concerning for third-party countries, including developing economies, where the drawbacks of such frictions might overshadow any occasional benefits gained from competition among the three major poles. What's more, considering that these third-party countries have less bargaining power compared to China, the United States, or the EU, a potential shift away from a multilateral model towards more direct power dynamics could limit their ability to assert their preferences effectively.

II • The polarisation scenario

The second scenario would stem from an increasingly contentious Sino-American relationship, resulting in the global economy's compartmentalisation and an accelerated decline of the multilateral regulatory framework. The clause that makes the new North American trade agreement (USMCA) conditional on the absence of agreements with countries considered "non-market economies" provides insight into the tools that could underpin such a system. Given the current level of global economic integration, this scenario would not resemble the near-complete isolation seen during the Cold War. Instead, it would involve two zones with distinctly different and, therefore, exclusive regulatory frameworks. While the complexity may be less than in the previous scenario, it does not necessarily lead to reduced friction. The heightened conflict between different regulatory approaches and resulting geo-economic tensions from this polarisation may outweigh the benefits of non-overlapping frameworks. The risk of heightened friction is especially concerning for Europe, as it would come under intense pressure to fully align itself with one or the other regulatory pole. Additionally, in a world where power dynamics prevail over legal principles, the EU may find that it is less adept and effective than other major trading powers when it comes to ensuring its interests are respected by other countries.

III • The optimistic scenario

In a more hopeful scenario, a new multilateral order would emerge by 2035, one that facilitates the harmonious coexistence of the differing and immutable preferences of key stakeholders. Here, a WTO 2.0 would continue to provide a stable and transparent framework aimed at minimising the predatory effects arising from the economic policies of its members. While appealing, this scenario would still require finding ways to reconcile the conflicting preferences of different parties regarding the multilateral economic framework. In spite of the active discussions among experts on overhauling the international economic order, clear and definitive solutions have not yet emerged.

• Recommendations

The last scenario is the best in theory for global well-being, owing to its clarity, stability, multilateral approach, and adherence to principles of law. This should make it a top priority for the European agenda, which is always mindful of these fundamental principles. To get there, the EU must lay out uncompromising red lines for a revamped WTO, explicitly emphasising the fundamental objectives of fairness, transparency, and predictability that underpin Europe's positions.

The current lack of progress in this area, however, calls for strategic recommendations on how to advance this priority, along with backup solutions until substantive advancements are achieved. The plurilateral agreement to establish an interim dispute settlement body (Understanding on Rules and Procedures Governing the Settlement of Disputes)[3] is a first example of these fallback solutions, which are primarily defensive in nature. A more proactive approach would be to form voluntary groups of countries operating within a WTO+ framework to address identified deficiencies. A good example is the trilateral partnership between the EU, Japan, and the U.S.

Implementing independent European measures that assert our regulatory preferences while remaining aligned with WTO principles would achieve a dual purpose.

First, these measures would better shield Europe from the adverse effects of the existing international trade framework's ongoing erosion and from external pressure to conform to the regulations of other parties. At the same time, these measures would increase the costs for non-cooperative trading partners, as their access to the European market would gradually face increasingly stringent constraints. This would encourage cooperation with the EU in establishing a common framework. To achieve this, in addition to upholding the fundamental principles of the WTO, these European measures should be designed to allow them to align seamlessly with partners who genuinely desire to cooperate. The EU's current Carbon Border Adjustment Mechanism proposal is an excellent example of such an approach. This barrier to accessing Europe's single market aims to comply with WTO rules and allows cooperation with affected partners, especially developing countries.

The EU will need to complement any regulatory measures and the ambition of a WTO 2.0 with significant efforts in engagement and communication. This could lead to bespoke agreements for each instrument, but the ultimate goal is to aim for comprehensive agreements focused on the transparency, comparability, and compatibility of regulatory frameworks. In this context, the regulatory aspect of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP),

3 WTO. Understanding on rules and procedures governing the settlement of disputes - legal text. https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm

signed in 2018, could serve as a blueprint for the development of an international regulatory framework.

Additionally, a fundamental requirement for any WTO 2.0 would be to ensure its appeal and relevance to emerging economies. Often sidelined in international economic discussions due to the Sino-American trade war, these countries have long expressed dissatisfaction with the existing framework. Therefore, in addition to advocating for reform, a constructive proposal from the EU could also serve to prevent Beijing and Washington from opportunistically mobilising these emerging economies in opposition, thereby enhancing the prospects of meaningful discussions for a new and improved common framework.

China isn't shy about fuelling the resentment of emerging economies towards the EU's stances, particularly its environmental trade barriers, even though the EU strives to ensure compliance with WTO rules. A pragmatic European proposal could offer a more flexible framework for industrial policies (a demand from emerging economies) in exchange for efforts on environmental issues (an EU preference). This proposal would be crucial to the EU's commitment and visibility with developing countries.

7.

China's trend towards de-dollarisation and the role of the EU

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Following the war in Ukraine and the increasing weaponisation of the dollar by the United States, China has stepped up efforts to increase the renminbi's share in trade financing, international monetary transactions, and foreign exchange reserves. The aim is not only to facilitate Chinese outbound investment and lower transaction costs, but also to make the renminbi one of the main currencies for global trade and finance. It is meant to put limits on the role of the dollar in the international monetary system and allow Beijing to create an alternative financial structure for payments which could prove essential in case of Western sanctions imposed on China following an eventual disruptive move against the international order, like the invasion of Taiwan or the active selling of arms to Russia.

We examine current trends in - and the future prospect for – China's de-dollarisation strategy and renminbi internationalisation, including discussion of the role that the EU could have in accelerating, or making it more difficult, for these trends to continue. We propose three scenarios: in the first, we argue that China's efforts at reducing the use of the dollar and at increasing the amount of renminbi in international transactions, especially in the so called "Plural South", is set to continue in a gradual way in the next years (scenario 1). However, the pace of this dynamic will depend much on whether Europe will actively support it and embrace wholeheartedly a multipolar international monetary system (scenario 2), or whether there will be a transatlantic alignment aimed at making it more difficult for Beijing to internationalise its currency (scenario 3).

I • Scenario 1 - China's gradual de-dollarisation and RMB internationalisation

Although the US dollar still reigns supreme, there are certain undercurrents that indicate the slow erosion of its global dominance and the gradual shift towards a multipolar currency order, a trend led in particular by China and, to a lesser extent, Europe.[1]

1 Otero Iglesias, M., & González-Agote, A. (2023, May 30). Is US dollar hegemony under threat?. Elcano Royal Institute.

Several global shocks, including Russia's invasion of Ukraine and the weaponisation of the dollar as well as the US Federal Reserve's interest-rate hiking cycle, have led Chinese leaders to step up efforts at de-dollarisation and further internationalisation of the renminbi (RMB or yuan). De-dollarisation can be defined as a movement to reduce reliance on the dollar, while the internationalisation of the RMB is an active strategy that Beijing is promoting to insulate itself from US (and possible EU) sanctions, reduce exposure to foreign exchange rate fluctuations and ultimately gain the prestige of a great power with a great currency.

In this first scenario the trend will continue at a gradual pace in the next years, also considering that the Chinese Communist Party (CCP) seems more interested in steady de-dollarisation rather than accelerated renminbi internationalisation.[2] Chinese leaders remain highly attuned to the risks associated with capital-account liberalisation, including capital flight and exchange-rate volatility. For this reason, Beijing is elevating the Chinese currency in a gradual fashion: first promoting the RMB as a medium of exchange for cross-border trade and investment settlement, and then gradually expanding capital-account convertibility to facilitate the long-run development of the RMB as a reserve currency.

China's de-dollarisation process reached a milestone in March 2023, when the RMB became the most widely used currency by China in cross-border payments, surpassing the US dollar for the first time. Moreover, several countries like Brazil, Argentina, Russia, Saudi Arabia, UAE, Iraq and Southeast Asian nations have announced that they will start settling trade with China using the RMB. Vladimir Putin went even so far as to declare that he was now keen on using "the yuan in payments between Russia and countries of Asia, Africa, and Latin America", an unprecedented move by a Russian leader.[3]

On 14 April 2023, Chinese President Xi Jinping and Brazilian President Lula da Silva agreed to 'strengthen local currency trade', signing an agreement to conduct trade using their domestic currencies. It needs

2 Sher, N. (2023). Serving the Real Economy: From De-dollarisation to RMB Internationalisation? *China Brief*, 23(9).

3 Stognei, A. (2023, March 26). Russia embraces China's renminbi in face of western sanctions. *Financial Times*.

to be noted that China is Brazil's largest trading partner and that their bilateral trade soared to a remarkable $150 billion in 2022.

At the end of April, Argentina's Economy Minister announced that the country would begin buying $1 billion worth of monthly imports from China using RMB. Argentina's Secretary of State for Trade, Matias Tombolini, also revealed in June 2023 that his country had settled transactions worth a staggering $2.721 billion with China, using the yuan as the main instrument of transaction.[4]

In June 2023, Pakistan utilised Chinese yuan to pay for its inaugural government-to-government purchase of 100,000 tons of Russian crude oil, which marks the country's first international transaction in a currency other than the US dollar.[5]

Crude oil and Liquefied Natural Gas (LNG), in particular from Gulf countries, are increasingly settled in yuan. On 28 March 2023, Beijing executed its inaugural cross-border settlement in yuan for LNG sourced from the United Arab Emirates (UAE). A few days later – and ahead of Emmanuel Macron's visit to China - France's TotalEnergies and China National Offshore Oil Corporation completed Beijing's first purchase of imported liquefied natural gas, a transaction that was settled in RMB through the Shanghai Petroleum and Natural Gas Exchange.

The Chinese government has outlined its strategic objective of enhancing the utilisation of the yuan by leveraging the Shanghai Cooperation Organisation (SCO), the BRICS and regional trade agreements. In September 2022, the SCO released a 'roadmap for the gradual increase in the share of national currencies in mutual transactions', while the BRICS summit in South Africa in August 2023 put on the agenda the creation of a new joint BRICS currency with the aim to help the bloc's members to lessen their reliance on the US dollar.

4 Martinez, J. (2023, June 17). Argentina highlights progress of yuan-based import Operations from China. *The Rio Times.*

5 Khalid, I. (2023, June 21). De-dollarization and emergence of Chinese yuan. *Geopolitical Monitor.*

Furthermore, within the Regional Comprehensive Economic Partnership (RCEP) including ASEAN members, China, South Korea, New Zealand, Australia, and Japan, there has been a notable increase in yuan-denominated remittances, rising to 18.9% in 2022 from 7.1% in 2020.

At the end of March 2023, the use of Chinese yuan in foreign-exchange swaps underwent the second-largest quarterly surge according to Bloomberg.[6] In the first quarter, swap line balances accounted for 109 billion yuan, or 20 billion more than the previous quarter, indicating a global de-dollarisation swing, as many central banks are moving away from reliance on the greenback.[7]

As China is the largest trading power for goods in the world, it is natural for its trading partners to opt for the RMB in trade settlement. It is also logical that China builds alternative interbank payment systems to the US-dominated SWIFT in the form of the Cross-border Interbank Payments System (CIPS), though the use of the latter is still limited compared to SWIFT. In our first scenario, this will not shake up the US dollar's status as the pre-eminent international currency – at least for the foreseeable future. The greenback will continue to dominate global trade, finance, and the reserve portfolios of central bankers around the world.

The US dollar remains the major currency for international settlement by a wide margin. In 2022, 70% of China's cross-border trade was invoiced in dollars, followed by the RMB at the rate of 19%; the euro came in third place.[8] According to data from the International Monetary Fund, at the end of 2022, the US dollar made up 58.36% of central banks' forex reserves, securing the safe first place, followed by the euro at 20.47%, the Japanese yen at 5.51%, the British pound at 4.95%, and the RMB at 2.69% in fifth place. The RMB is thus still far away from being able to dethrone the US dollar. Moreover, by April 2023, 43% of all global payments made via SWIFT were made in the US dollar, while

6 De Mott, F. (2023, May 16). China expands de-dollarization push as global central banks use record amount of yuan. Markets Insider.
7 Liu, Z. Z. (2022, September 21). China is quietly trying to dethrone the dollar. Foreign Policy.
8 Xinzhen L.. (2023, May 12). Debunked: China's de-dollarization. *Beijing Review*.

32% were made in the euro. Only 2.3% of the SWIFT transactions were made using the yuan.

Greater international use of the renminbi in the coming years will thus mainly provide channels for sanctions-busting. China will - more than pushing for the yuan to become the dominant global reserve currency – likely pursue its sphere of currency influence among countries it trades with actively, focusing on breaking up US dollar dominance in the "Plural South". However, this scenario could change depending on Europe's capacity to either support – and even accelerate – a greater use of the RMB in international transactions and push for a multipolar monetary order (scenario 2), or make it more difficult for China to achieve its monetary ambitions, should an anti-RMB entente between the EU and the US emerge in the near future (scenario 3).

II • Scenario 2 – Europe's support for China's monetary ambitions

Europe is the world's largest trading power and has well-developed capital markets, though the lack of capital market union is slowing down the internationalisation of the euro. Since the entry into circulation of the European common currency – possibly the only serious alternative to the dollar – the EU has stepped up efforts to develop the global role of the euro, reflecting the euro area's economic and financial weight. In its Communication *Towards a stronger international role of the euro*, the European Commission states that strengthening the international role of the euro would 'provide market operators across the globe with additional choice and making the international economy less vulnerable to shocks – and political decisions – linked to the strong reliance of many sectors on a single currency'.[9]

China has traditionally viewed the euro as an important element for the creation of a multipolar currency system in which also the renminbi would have its rightful place.[10] Over the years, China and the EU have developed

9 European Commission. (2018). Towards a stronger international role of the euro (COM/2018/796 final).

10 Otero-Iglesias, M. (2014). The Euro, The Dollar and the Global Financial Crisis. London: Routledge.

strong ties in the monetary field. Beijing has not only declared its support for the euro on many occasions and in crucial moments but has also diversified its foreign exchange reserves — the world's largest — so that it now holds over one-third in euros and slightly more than half in dollars. China's dollar reserves have decreased by around 30 % since 1999, when the European common currency came into circulation. China's diversification of its foreign reserves has accelerated since August 2011, when Standard & Poor's downgraded the credit rating of the US federal government from AAA (outstanding) to AA+ (excellent). Sino-European financial and monetary links deepened as a result, because China began divesting away from dollar-denominated assets and purchased growing quantities of eurozone bonds, in particular German Bunds, which were perceived to be safer than US Treasuries.

In turn, the Europeans have been supportive of an increased role of the Chinese currency in the world economy. Europe is today home to the largest number of renminbi bank clearings or offshore hubs where the Chinese currency can be traded. This indicates Europe's willingness to promote the use of the Chinese currency. In the same vein, most of Europe's central banks, chief among them the ECB, have accepted China's currency as a viable reserve and signed swap agreements with the People's Bank of China (PBOC). Although London is currently the most important offshore market for renminbi trading, after Brexit a significant share of renminbi trading has moved to the continent, in places such as Paris, Frankfurt, and Luxembourg, thus strengthening the China-EU monetary axis even more.[11]

European businesses can now settle RMB payments using clearing banks located in almost all EU member states. Moreover, several financial centres, stock exchanges trading Chinese securities and market-connect mechanisms linking to Chinese exchanges have emerged in various European countries, including the United Kingdom, France, Germany and Luxembourg. Many European stock exchanges are sponsoring special China-exchanges for Chinese securities such as the China Europe International Exchange (CEINEX) that – launched in November 2015 - runs on Deutsche Börse's platform and the London-Shanghai Stock Connect which was launched in June 2019.

11 Casarini, N. & Otero-Iglesias, M. (2017, August 30). Europe's Renminbi romance. Project Syndicate.

Not surprisingly, Germany is at the forefront of Europe-China financial links. Based in Frankfurt, the CEINEX is a joint venture established by Shanghai Stock Exchange (SSE), Deutsche Börse Group (DBAG), and the China Financial Futures Exchange (CFFEX). It is the first dedicated trading venue for China – and RMB – related investment products outside of Mainland China. Its mission is to establish a centralised marketplace for trading, risk management and asset allocation for China-related or RMB-denominated financial products in Europe. France is currently discussing with China the possibility of developing a similar connection between Euronext Paris and the Shanghai Stock Exchange. During the 2021 China-France High Level Economic and Financial Dialogue, the two sides launched the France-China Cooperation Fund with the involvement of China Investment Corporation (CIC), BNP Paribas and Eurazeo (a leading global investment group) to boost the Fund's role as a cross-border investment platform and promote the use of the renminbi among French businesses.[12]

According to the SWIFT-produced RMB Tracker, Europe is only second to Hong Kong when it comes to global cross-border RMB transactions. At the end of 2022, Hong Kong cleared 75% of RMB-denominated payments while Europe as a whole clears more than 10% of the world's RMB-denominated payments and there is every reason to think Europe's market share will continue to rise – a trend that will certainly accelerate given expanding Sino-European economic ties. It is worthwhile mentioning here that in 2022 bilateral trade reached the staggering volume of over €850bn.

In this context, the use of China's Cross-Border Interbank Payment System (CIPS) in Europe is expected to grow. Of the 1,300+ financial institutions connected to the CIPS, more than 170 are in Europe, including some of the biggest banks such as HSBC, BNP Paribas, Deutsche Bank and Banca Intesa. The European banks connected to the CIPS tend to clear renminbi (or yuan) funds used to finance infrastructure projects under Beijing's Belt and Road Initiative, but the scope of their RMB-denominated services keeps expanding.

12 DG Tresor. (2021). China-France Joint Fact Sheet on the 8th High Level Economic and Financial Dialogue.

So far, the internationalisation of the renminbi has proceeded slowly, but gradually - and Europe has become central to Beijing's plans to make the Chinese currency a global reserve currency. Alongside the establishment of currency swap agreements between the People's Bank of China and European central banks; the establishment of yuan clearing banks (so-called "renminbi hubs"); and growing use by European banks of China's CIPS, the Europeans have also lent their support to an increased role of the renminbi in the global economy. For instance, the Europeans unanimously backed the decision by the IMF in December 2015 to include the renminbi in the basket of currencies making up the Special Drawing Right (SDR), a synthetic reserve currency that includes the US dollar, the euro, the British pound, and the Japanese yen.

Washington has repeatedly stated its opposition to the inclusion of the renminbi in the IMF's basket, on the grounds that the Chinese currency does not yet meet the criteria for reserve status – a position that highlights the difference between Europe and the US regarding the renminbi's global role and, more generally, China's monetary ambitions.

Europe's backing for the renminbi is clearly political, also made in recognition of the support that Beijing gave to the eurozone during the sovereign debt crisis in 2011-2012. At the time, Chinese authorities made various declarations in support of the European common currency and the PBOC stepped in to buy eurozone bonds, including those of Greece, Portugal, Spain and Italy which were under speculative attacks from Wall Street and London- based international banks and hedge funds. Beijing's confidence in the eurozone did not go unnoticed. In return, EU policymakers (like Mario Draghi, Italy's former Prime Minister and former President of the ECB, and François Villeroy de Galhau, Governor of the Bank of France) have come to support Chinese monetary aspirations. Reducing the power of the dollar in EU-China relations would also give monetary content to French President Emmanuel Macron's much touted concept of 'strategic autonomy'.

There is, however, the risk that the acceleration of the de-dollarisation benefits more the renminbi than the euro, unless the Europeans can keep control of these trends and secure a strategy that benefits the EU. Moreover, in a world where the renminbi is widely used, it cannot be ruled out the possibility for European companies to be exposed to

Chinese extraterritorial measures, as much as they are now to US extra-territorial measures.

Finally, the EU's capacity to support China's monetary ambitions does not depend only on whether this is perceived to be in the strategic interest of the old continent but remains linked to Europe's capacity to be more autonomous from the US in the security and defense fields, since the connection between international monetary usage and military capabilities is well established.[13]

III • Scenario 3 – A US-EU entente against the renminbi

In this scenario, the EU caves into US pressure and decides to enter an anti-RMB entente with the US, using its monetary clout and financial capabilities to hinder a greater use of the RMB in the world economy. In the last years, under the leadership of European Commission President, Ursula von der Leyen, Europe has aligned its position on various China-related issues with that of the US. One mechanism where this transatlantic cooperation has been forged is the EU-US Trade and Technology Council (TTC) set up in June 2021. However, the question of the renminbi and its global role has only been marginally discussed so far in the context of the TTC.

The US has criticised the Europeans for not taking into consideration that the renminbi does not yet meet the criteria for reserve status.[14] This would require China to open its capital account, meaning it would allow companies, individuals, and banks to move money without overbearing rules and government approvals; let its currency float freely; and loosen government control over its central bank. None of this has happened. According to the US, a wider use of the renminbi in the world economy risks not only to embolden Beijing at a time of growing US-China tensions, but also to undermine future sanctions in case of a conflict over Taiwan.

13 Helleiner, E. (2008). Political determinants of international currencies: What future for the US dollar? *Review of International Political Economy*, 15(3), 354–378.

14 Reuters Staff. (2016, September 29). China Yuan "quite a ways" from reserve currency status.

The lasting war in Ukraine and overt strategic dependence on Washington could press the EU to align its stance on the RMB with that of the US. This entente between the transatlantic allies would aim at hindering Beijing's monetary ambitions, especially in the possible new era of Central Bank Digital Currencies (CBDCs). It would make it more difficult for China to de-dollarise and, more importantly, to internationalise its currency. Yet the US and the EU would still need to convince the countries from the "Plural South" to restrain from using the (digital) yuan in their transactions with China while most of them do not buy into the Washington-led narrative of dividing the world between democracies vs autocracies to isolate China.

Instead, the US and the EU would need to promote and implement a more positive (and not China reactive) agenda in their dealings with the "Plural South", which in turn would imply to give these countries more saying in the reconfiguration and possible construction of the new political, economic, and monetary world order.

Finally, by aligning on the US resistance to de-dollarisation, the Europeans risk isolating themselves even more from the "Plural South" – a trend that would also have implications for the promotion of the euro among these countries.

Recommendations

- EU policy makers should pay more attention to Sino-European relations in monetary affairs and find ways to increase coordination between EU institutions (European Commission, European External Action Service) and the eurozone's institutions (ECB, European Stability Mechanism) on China-related monetary issues affecting the Union.
- The EU should consider appointing a person and/or create a desk within the European Commission DG ECFIN tasked to monitor closely China's de-dollarisation and internationalisation of the renminbi and the implications that these trends could have for the EU, the promotion of the euro, and transatlantic relations.
- EU policy makers should put the question of China's de-dollarisation on the agenda of the EU-US Trade and Technology Council (TTC) so as to start a reflection on this issue between the two sides of the

Atlantic – yet, the EU should avoid following blindly US China policy and isolating itself even more from the Plural South, since this could have implications for the promotion of the euro among these countries.

8.

China's economic engagement in Southeast Asia

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I . Setting the stage

WHY ASEAN MATTERS FOR THE EU

ASEAN[1] as a whole represents the EU's 3rd largest trading partner outside Europe (after China and the US) with more than €271.8 billion of trade in goods in 2022. The EU imports about US$ 180 bn from its ASEAN partners and exports some US$ 92 bn to them. In addition, the EU is the second largest direct investor in ASEAN countries, and also finances trade-related projects in the region. Together with financing, the EU is engaged in technical assistance and policy dialogue, particularly through two mechanisms.

- The ASEAN Regional Integration Support Plus (ARISE+) provides support on the technical level as well as financially for ASEAN integration and trade connectivity, in particular in the areas of trade facilitation, harmonization of standards, and transport and customs procedures.
- The enhanced Regional EU-ASEAN Dialogue Instrument (E-READI) brings together policy makers, private sector, and other relevant stakeholders from both regions to exchange information and discuss policy matters of common interest.

The two blocs have been close partners for more than 45 years now, and their relationship was elevated to a Strategic Partnership in December 2020. In its Strategy for Cooperation in the Indo-Pacific (2021), the EU recognized the centrality of ASEAN.

China's rising activism in the region through the Belt and Road Initiative (BRI, including the Digital Silk Road - DSR) has brought a mix of welcome opportunities and difficult challenges for the EU. The DSR for instance is far more than just an infrastructure project. It has become a vehicle through which Beijing pushes for an alternative to what it sees as US domination of the technology world. Building digital backbones helps China set standards for digital infrastructure and next-generation technology such as artificial intelligence, robotics, the Internet of Things, blockchain, serverless computing, and so on. Whether knowingly or

1 ASEAN comprises ten countries: Burma, Brunei, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam.

unknowingly, the choices made for hard infrastructure could potentially lock an economy into a technological sphere of influence.

For all these reasons, the evolution of ASEAN and of its relations with the two great powers in the region, China and the US, is of utmost importance for the EU.

ASEAN NAVIGATING SINO-US RIVALRY

Located at the center of the Indo-Pacific region, Southeast Asia is in a unique geographical position that makes it geopolitically significant. ASEAN, as an association of nations covering 4.49 million square kilometers, with a population of 660 million and a GDP of US$3.35 trillion in 2021, is a potentially important partner in the region. Since its creation in 1967, ASEAN has continuously strengthened its ties with major powers and increased its regional influence, thus gradually establishing its “centrality” in the regional affairs.

Interestingly, some countries in the region are linked (formally or informally) to the United States in the area of security, while all of them are tightly linked to China through trade and investment. Since the launch of the Belt and Road Initiative (BRI) in 2013, China has been seeking to increase its influence in the region, but amid the growing US – China strategic competition, ASEAN’s and individual Southeast Asian countries’ position is to keep a balance between the two great powers, and to display a resolute determination not to take sides.

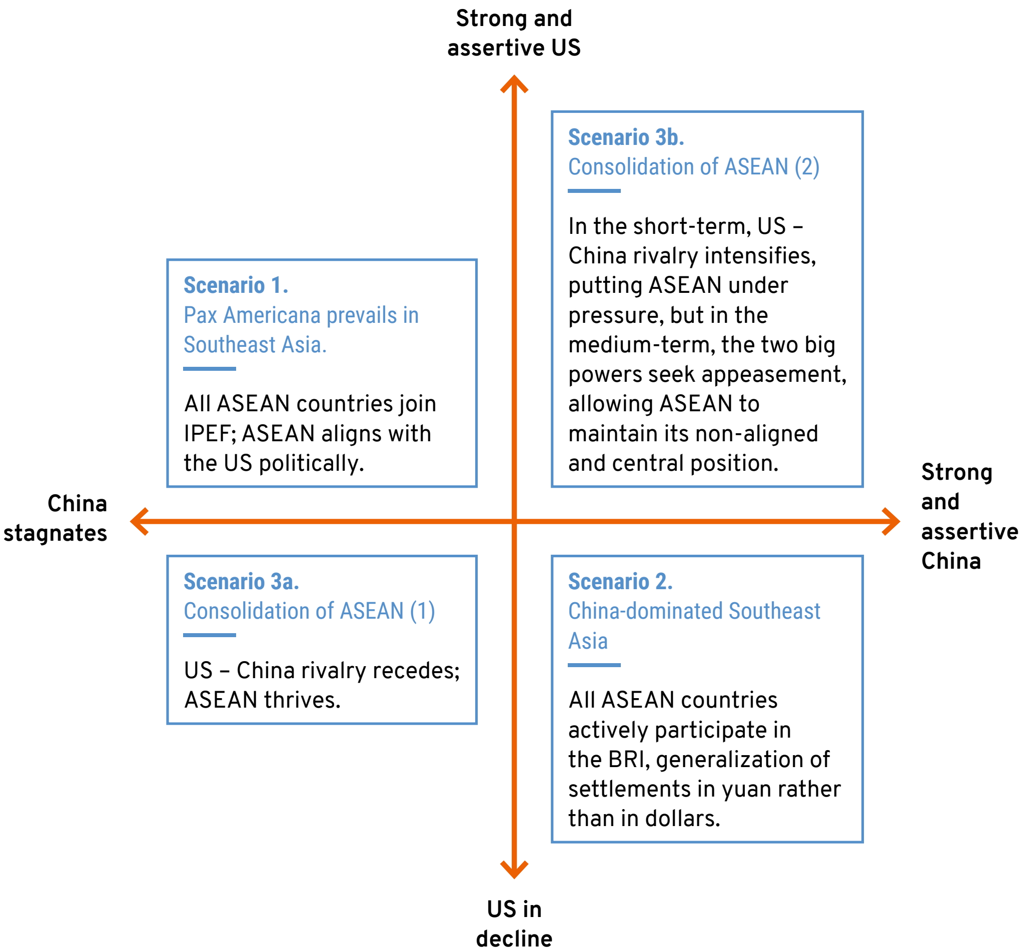
This delicate balancing act is likely to become increasingly difficult to maintain under the effect of a double pressure. On the one hand, while the United States had to some extent disengaged from the region in the economic sphere, it is seeking to reverse the trend, as exemplified by President Biden’s Indo-Pacific Economic Framework for Prosperity (IPEF) launched last May. On the other hand, China continues to implement the BRI, through numerous physical infrastructure projects, but also through the dissemination of its standards and practices, notably in the digital domain.

As the United States and China continue to engage in a global tug of war, Southeast Asian nations are increasingly pushed to take sides. If they were to make such a move, this could exacerbate superpower rivalry and risk turning the region into battleground, as it was during the Cold War.

While the hypothesis of an ASEAN explosion seems a priori excluded, the evolution of the ASEAN countries' relationship with their two major partners depends essentially on domestic developments in China and the US that will determine whether their rivalry continues to intensify or not.

In this context, three scenarios are therefore conceivable for the coming decade:

- Scenario 1: US-dominated Southeast Asia with China struggling to remain influential
- Scenario 2: China-dominated Southeast Asia with China tightening its grip over the region
- Scenario 3: China – US rivalry recedes and ASEAN consolidates
  - as a result of a deliberate de-escalation of tensions (**3b**) or
  - as a result of a parallel decline in the US and China (**3a**)



Strong and assertive US
Scenario 3b.
Consolidation of ASEAN (2)
In the short-term, US – China rivalry intensifies, putting ASEAN under pressure, but in the medium-term, the two big powers seek appeasement, allowing ASEAN to maintain its non-aligned and central position.
Scenario 1.
Pax Americana prevails in Southeast Asia.
All ASEAN countries join IPEF; ASEAN aligns with the US politically.
China stagnates
Strong and assertive China
Scenario 3a.
Consolidation of ASEAN (1)
US – China rivalry recedes; ASEAN thrives.
Scenario 2.
China-dominated Southeast Asia
All ASEAN countries actively participate in the BRI, generalization of settlements in yuan rather than in dollars.
US in decline

II • Scenario 1: The US imposes its rule in Southeast Asia, while China loses ground

In the next couple of years China – US rivalry continues unabated; however, as a result of growing domestic difficulties (ageing population, slowdown in economic growth, social instability, failure of recent economic policies), China is gradually no longer in a position to compete on an equal footing with the US. It is forced to trim the BRI's scope and ambitions and cannot keep up the pressure on its Southeast Asian partners. Distracted from its power projection plans by a marked economic slowdown and rising social instability, the Chinese government is forced to abandon most of its projects in the region, leaving the way clear for the US.

The US economy in contrast recovers quite forcefully as a result of the Biden administration's reindustrialization strategy. These positive domestic developments contribute to a bolder foreign policy and a strengthening of the rebalancing towards Asia. As a crucial part of its "Indo-Pacific Strategy," the US seeks to expand the Quad to include ASEAN countries; at the same time it starts building new "mini-lateral" mechanisms among its allies and partners to carry out cooperation in terms of security, technology and trade.

In this context, the US attaches great importance to cooperation with ASEAN members. In the political sphere, the Biden administration had upgraded the US-ASEAN relationship to a comprehensive strategic partnership in 2022. On the economic front, the Biden administration had invited several ASEAN members to join the Indo-Pacific Economic Framework. In the security field, the US had boosted military cooperation with many countries in the region, starting with the Philippines. All these moves are strengthened in the following years.

IMPLICATIONS FOR THE EU

In such a context, the EU will increasingly focus on ASEAN as partners in East Asia, while China's attractiveness will be receding. However, the relationship with China will also be appeased as it will become a minor partner and will no longer be perceived as a systemic rival.

At the same time, tensions between the US and the EU are likely to rise due to their diverging views on some important aspects - such as digital trade for instance.

III • Scenario 2: The US loses credibility, China asserts its leadership in Southeast Asia.

The takeover of Taiwan by the PRC (in 2027, as anticipated by some analysts) does not trigger the military intervention expected from the United States, thus undermining the confidence placed in them by the countries of the region. Under these conditions, the latter turn to China, which seems more likely to guarantee their economic stability and prosperity.

Even under less extreme conditions, the US clout may decline quite dramatically and induce China's rise in parallel. Persistent strategic ambiguity and the lack of reaction to minor incidents in the Taiwan strait may gradually erode US credibility.

As a result of such developments, the US is losing influence in the region (East Asia), particularly over ASEAN countries, and China is poised to fill the power vacuum thanks to its extensive economic ties in the region, ties that many in Southeast Asia are dependent on for sustainable development, despite reservations over the possible negative ramifications of increased Chinese economic and diplomatic influence in the region.

At the same time, China has succeeded in promoting its soft power through initiatives such as the Belt and Road Initiative (BRI), which aims to enhance connectivity and economic cooperation between China and other countries. Moreover, the use of the yuan (rather than the dollar) in intra-regional trade will be gradually generalized.

IMPLICATIONS FOR THE EU

For the EU competing with China in Southeast Asia will prove extremely difficult, and even more so since China is unlikely to let the EU develop its influence strategy. For instance, even pushing EU's Global Gateway not as an alternative but as a complement to BRI will prove challenging. As a result, tensions between China and the EU will intensify.

IV . Scenario 3a: Consolidation of ASEAN

Although the degree of economic integration between ASEAN countries is far from approaching that of the European Union, progress has been real and steady, and the ten members of the Association now constitute a coherent economic zone within which goods, services and, to a lesser extent, capital and people circulate freely. On the strength of these results, the ten member countries are now in a position to organize themselves collectively to face up to their two major partners.

With China – US rivalry receding, ASEAN is free to consolidate its autonomous position and continues to navigate astutely between the two great powers. At the same time, it seeks to diversify its partnerships by engaging more forcefully with other countries in the region such as Japan and Korea, but also outside the region, leaving many options open for the EU.

IMPLICATIONS FOR THE EU

In the context of a decline in China-US rivalry in Southeast Asia, the EU will be able to take a more proactive stance vis-à-vis ASEAN as a bloc, as well as vis-à-vis individual Southeast Asian countries. Indeed, the EU is perceived as a trusted partner, and is widely thought to be able to provide some strategic equilibrium.

The EU and ASEAN will continue to deepen their relationship, that had already been upgraded to a strategic partnership in 2020. In line with the objectives outlined in its 2021 Indo-Pacific Strategy, the EU will increase engagement with Southeast Asia and reinforce cooperation with ASEAN. As a result, ASEAN will soon become the EU's number one partner in the region, ahead of China.

At the same time, China will also likely be more willing to cooperate with the EU in Southeast Asia, accepting for instance that EU's Global Gateway may complement the BRI.

V . Scenario 3b: Consolidation of ASEAN

The decline in intensity of Sino-US rivalry may be the result of a deliberate strategy by the two partners who both realize that it does not make sense to push their rivalry forward and gradually choose to do everything they can to move away from a zero-sum game (lose-lose game) towards some form of cooperation. In other words, such a situation of "mutually-assured cooperation", is the result of the two parties finding a modus vivendi that will contribute to deescalate bilateral tensions.

A similar outcome may also result from a weakening of the two partners who can no longer afford to constantly raise the level of their rivalry.

IMPLICATIONS FOR THE EU

At first, the EU will be able to take advantage of ASEAN's willingness to avoid being trapped in a binary decision and could be ASEAN's best bet in hedging against some of the uncertainties brought about by US-China rivalry.

Over time, as the two great powers move away from a confrontational stance, the EU can again engage in a more pro-active strategy. In ASEAN the EU has been perceived for a long time as able to demonstrate global leadership in maintaining a rules-based order and upholding international law.

Again, as in the previous scenario, the potential for cooperation with China in Southeast Asia will rise.

9.

China, ASEAN, ASEAN+3, ASEAN++, and the Global South

Jean François Di Meglio
Chair, Asia Centre

China's strategic push to expand its global clout hints at several potential ways its relationships with different partnership circles could develop. The foremost is regional, epitomised by the ASEAN[1] trade bloc, within which China (under the "ASEAN + 3" framework) loosely collaborates with pivotal partners Japan and South Korea. Other partnerships have formed, especially after the UN's March 2022 vote on Ukraine and China's increasingly transparent attempts to bring these nations into its fold under the banner of the "South." The intersections of groupings like BRICS, the Shanghai Cooperation Organisation (SCO), and the Regional Comprehensive Economic Partnership (RCEP) highlight these trends. Yet, the future of these relations remains fluid and unpredictable, offering a rich tapestry of potential outcomes to weave.

The final communiqué of the ASEAN Foreign Ministers' meeting on 13 July 2023, attended by China's Minister of Foreign Affairs and his American counterpart, Antony Blinken, highlights the nuanced postures of ASEAN and the broader "Global South" towards China. While analyses, such as those from The Economist[2], suggest the imminent rise of a China-centric world order fuelled by the solidarity and vindictive spirit of southern nations, it's a stretch to believe that the only scenario is the steady emergence of an expansive non-Western bloc that includes ASEAN members.

The summit's final statement is not binding for Chinese and American observers and remains relatively vague about the intentions of the ten ASEAN countries. However, it clearly references the 2019 AOIP (ASEAN Outlook on the Indo-Pacific). While this document—which is supposed to represent ASEAN's official stance in the Indo-Pacific—has undeniable anti-China undertones, it is shrouded in ambiguity. There could probably be less scepticism regarding "ASEAN +3" since the closer ties between South Korea and Japan signal an apparent distancing from China. Still, disputes like Fukushima's controversial release of radioactive water into the ocean and the subsequent China-South Korea alignment show how challenging it can be to establish clear boundaries and consistent positions. Elsewhere, Indian Prime Minister Narendra Modi's presence in Paris for France's Bastille Day celebra-

1 ASEAN comprises ten countries: Burma, Brunei, Cambodia. Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam.
2 *The Economist.* (2023, July 6). China's message to the global south.

tion and India's confirmed orders for French military equipment does not erase the fact that the "multi-alignment" strategy championed by the Hindu nationalist BJP government showcases the dualities in India's position and the wavering stance of the "non-bloc" known as the "Global South." Such mixed signals suggest multiple potential scenarios for China's relations with key partners, each distinct but not necessarily conflicting.

The SCO's recent expansion to include Saudi Arabia and Iran may give credibility to the rise of a global governance model influenced by China, grounded in solidarity with the Global South.

As a result, while the scenarios outlined below might appear divergent and sometimes contradictory, they can also overlap or encompass one another. But first, it's essential to discern the pivotal factors that underpin each scenario, recognising that they can intertwine and evolve in various ways.

SCENARIO: THE SHATTERED DREAM

- China experiences lukewarm post-Covid economic recovery;
- China struggles to revive domestic consumption and address internal economic challenges;
- China begins to lose its sheen;
- Belt and Road Initiative (BRI) projects face hurdles in financing and completion;
- China falls from favour within the RCEP.

SCENARIO 2: THE GREAT REPLACEMENT OR BANDUNG 2.0

- The Global Development Initiative (GDI) supersedes the BRI. China secures renewed geopolitical footing through strengthened ties with Saudi Arabia (a new SCO member) and greater prestige owing to a monumental agreement forged between Iran and Saudi Arabia;
- The RCEP proves successful;
- China retains its allure for countries with wavering stances, like ASEAN members, South Korea, and Japan.

INTERMEDIATE SCENARIO: THE NOODLE BOWL, ALTERNATING GRAVITATIONAL PULLS, OR THE DISAPPEARANCE OF GLOBAL GOVERNANCE

- Nations individually navigate their way through myriad trade and defence agreements, giving rise to multiple "circles of collusion";
- The vacillation of certain countries makes it impossible to clearly delimit the different blocs.

I. Scenario 1: The Shattered Dream

BACKGROUND

The "Chinese Dream" of pursuing its suite of "G projects" (be it the GDI, GSI – Global Security Initiative, or GCI – Global Civilization Initiative) appeared to be gaining momentum owing to China's spirited diplomatic engagement with Southern partners and other global regions that seem to elude American influence. The Chinese President penned numerous memorandums of understanding (of varying specificity) with Asian and European countries eager to associate with a more comprehensive and nuanced BRI.

Yet, an assessment of collaborations with multilateral financing bodies of non-Chinese origin reveals that institutions like the Asian Infrastructure Investment Bank (AIIB), and even Chinese banks, often associate with the mainstays of what might be aptly described as the "global financial governance of yesteryear," especially outside of Africa. China's involvement at the Paris debt summit in June 2023 and the prospect of Chinese participation in the restructuring of Zambian debt within a "Paris Club" type framework highlight the difficulty of achieving complete financial decoupling that would have paved the way for an autonomous "Chinese debt galaxy."

Elsewhere in the world, just as in Africa, China's role as a lender does not necessarily ensure diplomatic ties or solidarity. Conversely, the new reserve currency idea called for by China and 23 of its Southern partners in August 2023, bolsters the credibility of a China-led financial and diplomatic order.

In light of these disparate trends and occasionally conflicting information, several factors suggest a “shattered dream” scenario:

- The impact of China’s economic and demographic slowdown on its foreign investments in neighbouring countries and partnerships with the more developed Asian nations;
- The potential reduction of the 17+1 format to a mere 1+1 (Hungary and China) and how China might interpret this setback, influencing ASEAN nations and the broader South wanting to align more closely with Beijing;
- The repercussions of American sanctions on Chinese technological innovation as it pivots to Southeast Asia and possibly even South Korea;
- The influence of increasingly powerful Chinese institutions on ambivalent nations like South Korea;
- The contrast between trade flows before and five years after the establishment of RCEP;
- The implementation or inertia of Japan’s new U.S.-backed defence policy;
- China’s stance of “non-involvement” on the war in Ukraine, and the ramifications on relations with ASEAN and Southern nations, especially following the June 2023 “Wagner episode” that created tensions in Sino-Russian relations;
- The official response of Asian nations to Taiwan’s 2024 elections;
- The direction of “North-South” relations following the 2024 U.S. presidential election, i.e. the continuation of a tempered “Biden-like” approach or the advent of a more disordered confrontation bolstering a Southern bloc around China.

Amidst these developments, China faces an unabating economic slowdown, unable to achieve its goal of becoming a technological powerhouse and assimilating the region into its innovation hub. The rapprochement between Japan and South Korea gains traction. China leaves the RCEP due to the support of Asian nations for Taiwan, albeit of varying levels. Tensions rise within the SCO and BRICS to the extent that some members begin to back American sanctions. China fails to set clear guidelines and precise charters to govern adherence to its new institutions and does not properly define how they operate, which wears out the patience of more resolute countries. The shift in U.S. policy following the 2024 presidential elections will play a pivotal role in this scenario. Depending on election results, we could see China strengthening its ties with Southern countries while maintaining a status quo with ASEAN or a faltering Chinese economy that could make Southern countries reconsider their relationships with China, realising that their ties bring them more disadvantages than benefits (as observed in the 17+1 format). The prospect of a powerful Chinese bloc that could instil confidence in ASEAN and draw in southern countries is gradually losing steam.

II • Scenario 2: The Great Replacement or Bandung 2.0

BACKGROUND

On the face of it, the plausibility of such a scenario is supported by the growing influence of the SCO, the expanding roster of BRICS nations, talks of a common currency, and the changing and unpredictable voting patterns observed of late in global forums by "swing" states like India (and even some countries who have a seat on the Security Council). Despite its ambiguous stance on Ukraine, China has not been ostracised by the global community. However, Beijing points to NATO's expansion and potential representation in Tokyo as evidence that it is being strategically cornered on the global stage.

The rise of China as a leader in regional and global governance hinges on several factors, including:
- Waning participation in time-honoured multilateral institutions;
- The gradual inclusion of new countries (predominantly from Northeast Asia) in Chinese institutions and the establishment of new governance rules within Chinese institutions or institutions that have its backing (akin to a refined AIIB blueprint);
- China's ability to apply "Iranian-style mediation" tactics to other global hotspots (Middle East, Burma, Africa, Korean peninsula);
- The success of international policies rooted in the "united front," "non-interference," and the "Beijing Consensus";
- The sidelining of issues related to Taiwan and the South China Sea, and China's partners rebutting the rules of the United Nations Convention on the Law of the Sea (UNCLOS) to instead adopt informal, bilateral,

or regional agreements on freedom of navigation, making China the pivotal regional governance authority. A resurgence of the Kuomintang in power could pave the way for trade agreement negotiations with Taiwan.

The unfolding of this scenario is subject to several prerequisites:
- South Korea's inclination to rekindle its relationship with China;
- Japan's inability to achieve the goals of its National Security Strategy related to military planning for the period 2023-2027;
- China's economic rebound, effectively managed and communicated, aiming for a 3-4% growth along with initiatives that support employment and weaker sectors of the domestic economy;
- China's ability to subsidise countries from the "former BRI" that are facing economic challenges;
- Clear and tangible success stories from the BRI that showcase China's prowess in lifting people out of poverty;
- The RCEP's rapid transformation into a powerhouse for regional trade (leveraging tactics similar to those of Taiwanese SMEs, e.g. triangular relocations to capitalise on lower tariffs). After being joined by China in the Trans-Pacific Partnership (CPTPP), the UK becomes a gateway for Chinese influence in Europe.

If these conditions align, Western influence would wane. China would negotiate a more favourable Comprehensive Agreement on Investment (CAI) with the EU. In addition to the Finnishisation of South Korea Taiwan, and "kulakisation" of Japan, ASEAN would be more subordinated to China. Collaborations akin to the China-Africa cooperation model (FOCAC) could be replicated in other parts of the world (Middle East, Central Asia, South-East Asia), featuring observer nations like South Korea and Japan. However, as illustrated by Germany's new stance on the CAI, too many conditions need to be met for such a scenario to unfold.

III • Intermediate Scenario: The Noodle Bowl, Alternating Gravitational Pulls, or the Disappearance of Global Governance

BACKGROUND

Many countries find themselves caught in opposing "gravitational pulls" that lead them into multiple alliances with conflicting objectives. For instance, they may simultaneously belong to the RCEP and other free trade agreements that create different regulatory, sometimes monetary, frameworks. Or they may join, as in India's case, conflicting security partnerships like the SCO and the Quad. Their international stances often shift depending on circumstances. While some are drawn in by China's allure and view the country as a benchmark, Beijing also breeds mistrust, even repulsion, in the region. The influential opinions of the Chinese diaspora in the region and the political subtleties of neighbouring countries (such as South Korea, Japan, Malaysia, Singapore, the Philippines, and Vietnam) are marked by their ambiguity and hesitancy to adopt divisive stances. This diplomatic tightrope can occasionally hinder China's growing influence in the "Great South," which remains keenly observant of Beijing's moves in the region.

The likelihood of this scenario will depend upon:

- The easing of American sanctions in the tech sector;
- The gradual collapse in foreign direct investment in China;
- The deterioration of China's balance of payments and unprofitable foreign direct investments;
- Tensions within the RCEP;
- India's rise as a new hub for relocation and a counterbalance in geopolitics.

If the U.S. becomes more receptive to China as a partner (whether out of necessity or realism), and as China's allure wanes in the face of India's rise, the notion of a "Great Decoupling" could be challenged. This would promote intertwined interests, thwarting the emergence of a "China's Great South."

Should this scenario unfold, we would witness:
- The end of bloc ideology, despite Chinese propaganda and steadfastness;
- Southeast Asian leaders maintaining their independence;
- A more defined diplomatic stance in Africa and Latin America;
- Emerging paradigms such as Singapore's "equidistance" or India's "multi-alignment";
- A rejuvenation of ASEAN, potentially expanded to incorporate South Korea, Japan, and Taiwan;
- A shift away from rigid Indo-Pacific strategies, the AUKUS, and the Quad, due to the continued marginalisation of "non-English-speaking" countries;
- A resurgence of ties between the European Union and ASEAN, signifying Europe's renewed engagement in the region.

It is difficult to see how this scenario, which is in reality very similar to the current situation, could be sustained and to understand why, given the doubts surrounding the Chinese model, China's main partners would forgo the benefits they were able to garner from their ambiguous stance in pursuit of the uncertain gains that they might derive from a dominant and central China. But this scenario warrants serious consideration. While the U.S. stance is the pivotal factor in the first scenario, India's position, involvement, influence, and the evolution of its "flexible" and opportunistic stance play a more decisive role in this third scenario (over and above the EU's role).

10.

The Taiwan Dilemma: Contemplating the Impossible, Averting the Conceivable

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I • Assessing a potential crisis in Taiwan

China's pressure on Taiwan extends beyond the usual diplomatic and military tactics. Its primary targets are not necessarily the island's tangible, physical assets. The real battlefield extends beyond the island nation's shores, where malleable perceptions and minds prove more vulnerable than the static and "unsinkable aircraft carrier" parked less than 200 miles off China's coastline. However, it is crucial to tread with caution, as Western (particularly European) narratives steeped in Schadenfreude seem to be bracing for an imminent attack, fanning the flames of media sensationalism that might, tragically, one day turn into reality. An assault on Taiwan—a rare beacon of democracy in Asia, an epicentre of cultural, political, and commercial openness, and a true powerhouse in the technology sector—would not only destabilise the region but send shockwaves reverberating around the world. The discussion that follows is not intended to rehash these grim points. The calculations and ramifications of a Chinese offensive against Taiwan have already been thoroughly dissected by a myriad of seasoned experts. Two studies warrant particular attention:

The Atlantic Council and Rhodium,[1] among others, estimate that a crisis in Taiwan could cost the global economy over $3 trillion. Their findings highlight the intricate web of global value chains, emphasising the potentially devastating impact a crisis would have on the semiconductor industry. The study also argues that the effectiveness of financial and monetary sanctions could dwindle over time, especially as China is already taking steps to formulate countermeasures, potentially developing an alternative currency anchored to its own trading and settlement infrastructure, thereby insulating itself from the impact of sanctions. It concludes quite logically that economic statecraft alone (even if sanctions come with clear forewarning of their potential impact) might not be enough to deter aggression.

The Economist Intelligence Unit (EIU)[2] takes a more regional approach to the issue, examining the direct and indirect impact of an acute crisis

1 Vest, C. & Kratz, A. (2023, June 21). Sanctioning China in a Taiwan crisis: Scenarios and risks. Atlantic Council.
2 Economist Intelligence Unit (2023) "Conflict over Taiwan: assessing exposure in Asia".

or a conflict sparked by Chinese action against Taiwan. The study compares the vulnerability of different Asian countries that would be caught in the crossfire of a crisis in the Taiwan Strait and the potential setbacks that China itself might experience.

II • Risks and reciprocal sanctions (ex-post and ex-ante)

Central to this debate is the need to gauge the impact of disrupting the current status quo, especially in a scenario devoid of sanctions. The European Union could set its crosshairs, and pre-emptively announce sanctions on Chinese investments and assets within the bounds of its 27 member states. This labyrinthine decision, however, is mired in complexities given that each country has its unique stance, exposure, and ability to stand up to China.

If Brussels were to impose such sanctions, the EU would likely feel the pain of retaliation in kind by China, given that European investments in China are considerably greater than the other way around. The potential backlash is already prompting European decision-makers, both in government and business, to reformulate their approaches, as illustrated by Germany's recently announced new strategy for its dealings with China.[3]

Ex-post sanctions could also have colossal indirect repercussions on the global financial system, primarily because of the significant amount of US debt that China owns and the potential default that could ensue (the situation for European debt is less critical).

However, should a consortium of EU countries be brave enough to take a stand and play the high-stakes game of "threats," the medium to long-term dividends might just be worth the gamble.

A well-planned deterrence strategy would not just maintain global stability but also shield against unforeseen supply chain disruptions (e.g.

3 Auswärtiges Amt. (2023). China-Strategie der Bundesregierung. https://www.auswaertiges-amt.de/blob/2608578/810fdade376b1467f20bdb697b2acd58/china-strategie-data.pdf

if Taiwan's chip giant, TSMC, decides to build semiconductor manufacturing plants in the European Union). It could even act as a bulwark against the swelling tide of China's influence in product standardisation, fostering true strategic autonomy and hastening the onset of the dreaded "great decoupling."

But before any of this happens, the EU needs a well-thought-out plan. It would be unrealistic and misguided to ponder retaliation strategies without explaining the risks and potential consequences for the EU to the general public well in advance. Moreover, any such strategy requires the unanimous support of all EU member states—each of which has its unique relationship with Taiwan—to succeed.

III • Possible courses of action following communication and awareness initiatives

The vigorous debates in France on social networks (which often feature contributions from engaged and well-informed individuals) do not accurately represent the prevailing sentiment in France regarding the situation in Taiwan. The French public seems largely indifferent, if not disinterested and contemptuous. The general mindset is that there are already considerable domestic problems to address, and France does not have the time or budget to pay attention to Taiwan.
There is a **significant gap** in awareness between the general public and those directly involved in international relations (public and private sectors).

There are also **considerable disparities** in perceptions surrounding the possible impact of sanctions on China, even if the end a conflict in Taiwan or a change in Taiwan's status would have major implications for the democratic ideals and economic balance for all of Europe.

Therefore, when the time comes to decide on potential sanctions, member countries might have considerably different positions. **Attempting to draw comparisons with Russia is not helpful** (even in the energy sector) since Europe's entanglements with China are much more complex and pervasive across multiple sectors (whereas with Russia, economic entanglements are not as deep or wide-ranging). While the intricate relationship with Beijing makes it more challenging to decide on sanctions, it also increases the potential value of the threat of sanctions. Indeed, due to the deep connections and mutual dependencies, imposing sanctions could result in substantial reciprocal damage (i.e. much more balanced than in the case of Russia).

Furthermore, defining "(co-)belligerence," which is already far from straightforward in the context of Ukraine, becomes even more difficult in the case of China due to a different set of circumstances and stakes, including freedom of navigation in the South China Sea, security in the French Indo-Pacific region, and the vulnerability of goods that are transiting through the area.

In step with the rather pessimistic studies cited earlier, sanctions can only be effective if they are:
- **Prepared**, coordinated, and harmonised within a group of unified countries;
- **Used** as a form of deterrence (i.e. involving a certain level of "strategic ambiguity") before being implemented. Otherwise, it would be "too late" (see below for more on the complexities involved in defining the scope, timing and nature of sanctions);
- **Accompanied** by effective communication to address the general public's concerns (e.g. impact on investment and employment, balance between reliance and "strategic autonomy").

To avoid falling into unrealistic or overly dystopian scenarios, the following practical measures should be explored:
- First level of deterrence:
  - Introducing exception clauses in any new Chinese investment contract in Europe, allowing for terms to be amended if the status quo in East Asia is not maintained.
- Second level of deterrence (targeting Chinese trade, assets, investments, and manufacturing facilities in Europe):
- Launching attacks on China (escalating gradually):
  - Severing all forms of connectivity and communication immediately (e.g. closing logistic routes and shutting down digital networks);
  - Announcing staggered customs duties (not immediately enforceable to give China the opportunity to change its behaviourover time and according to the products being imported or exported;
  - Freezing Chinese financial assets;
  - Imposing restrictions on Chinese residents in Europe, such as hal-

ting the issuance of residence permits to Chinese citizens (and revoking permits that have already been granted if cross-strait tensions escalate further) and terminating social benefits for Chinese residents with or without residence permits, including students.

- Meanwhile, preventive measures should be taken (with a concerted effort to communicate them effectively), including:
  - Building European stockpiles of strategic goods and finding potential alternatives to Chinese products;
  - Reducing European debt held by China and broadening the investor base;
- Developing ex-post emergency contingency plans, such as setting up a structure to potentially host a “Free Taiwan Government”, much like how London played host to several governments in exile during World War II.

However, none of these measures, whether announced or ongoing, will be credible without establishing unofficial “Track 2” dialogue, inspired by China’s very own “wolf warrior” diplomacy, that is not shy about going into the details of possible actions to bolster deterrence. This form of communication should include:

- Dispatching emissaries who have access to Chinese leadership and can unofficially, but well in advance, convey secure and substantiated messages that vary in tone and moderation based on the threat level.
- Communicating in parallel with the incumbent (or possible future) leaders in Taiwan to impart wisdom and a sense of relative reassurance to avoid crossing any “red lines.”

IV • Coming back to reality

At this stage, it is crucial to conduct a thorough and objective assessment of the circumstances, looking past any exaggerated negative predictions and focusing on understanding the current situation, the rationale for building different scenarios, and the possible intentions behind creating the prevailing pessimistic forecast.

Research centres and think tanks are tasked with building scenarios based on available information and play a significant role in analysing, commenting on, and advising on these matters.

But despite their meticulous efforts and outstanding research, they are unanimous in offering rather disheartening conclusions. The consensus is that any change to the status quo over Taiwan, whether through an attack or subsequent conflict, would lead to significant economic repercussions for all parties involved, both in the short and medium term.

The region's geopolitical and geoeconomic significance, along with the changes brought about by China's ambitions, are leading—when reading between the lines—to a curious form of resignation and fatalism. This sentiment reflects an inability to suggest practical solutions, either in terms of prevention or in the context of "mitigation" and "adaptation" (to borrow language used in discussions on climate change).

Before the publication of these studies, at a time when the risks were perceived as less acute (i.e. two years ago), Kevin Rudd's book *The Avoidable War: The Dangers of a Catastrophic Conflict between the US and Xi Jinping's China*[4] offered little in terms of constructive and valuable solutions for the various stakeholders, namely the United States, China, Taiwan, and even the rest of the world. Among the scenarios Rudd discusses concerning the future of Sino-American relations centred on the issue of Taiwan, very few are optimistic. Even when they are, they suggest a future akin to the Locarno and Stresa agreements, respectively in 1925 and 1935, when it seemed possible to exert pressure on dictatorships, bring them to the negotiating table, win them over, and focus on the merits of dialogue even amid volatile situations. This approach, a combination of coercion and realism, mirrors what Rudd recommends for dealing with China in the last pages of his book. Recall that in 1935 – nine years after Aristide Briand received the Nobel Peace Prize for his reconciliation efforts with the Weimar Republic, which facilitated Germany's accession to the League of Nations – the prospect of an imminent war triggered by the rise of Nazi Germany had been dismissed. *Il Duce* played along, endorsing the formation of a common front between his fascist dictatorship and Western democracies, a collaboration affirmed by the agreement made in Stresa. He would go on to invade Abyssinia later that year...

4 Rudd, K. (2022). The Avoidable War: The Dangers of a Catastrophic Conflict between the US and Xi Jinping's China. PublicAffairs. https://www.avoidablewar.com/

Discussions surrounding possible sanctions against an aggressive and expansionist China are intended to prepare nations for a "war economy" but also to underscore the inadequacy of the retaliatory measures being considered to prevent what seems inevitable.

Much like decisions made in Washington's situation room or a financial institution's risk committee, the focus must be on provisioning available resources (if there are any) while planning for the worst-case scenario to try to avert it.

But it is also possible that these strategic exercises and discussions might be aimed at influencing Beijing's decision-makers to maintain the status quo through a form of diplomatic deterrence (as was done in the time of international conferences in the first half of the 20th century). The fear elicited by the prospect of conflict might suggest a return to the "crypto-pacifist" spirit that used to guide French statesmen Aristide Briand and Pierre Laval. The strategy, therefore, would be to erect a "conceptual scarecrow" that dissuades potential aggressors from suffering the consequences of their actions.

One can hope that such a bet on the rationality of a dictatorship and its willingness to listen, might be a viable strategy. This bet also implies that Xi's regime can be influenced.

V • What would a crisis mean and represent?

It is essential to understand the (very real) risks that could lead to a crisis and evaluate the serious consequences of disrupting the current status quo.

The reality is that China is probably not ready or willing to engage in high-risk ventures, especially considering the balance of forces and the potential for failure in a military operation against Taiwan. Beijing is also likely reluctant to spread itself too thin amidst an increasingly fragile domestic economy. Beijing has ramped up military pressure on Taipei by repeatedly flying fighter jets into Taiwanese airspace and conducting increasingly provocative military exercises around the island. These activities represent a clear escalation. But they might also be a way for China to gauge the situation and improve its understanding of the terrain.

Military leaders are held under the watchful eye of the Chinese Communist Party, but their bellicose statements occasionally bypass censorship controls. So while military action is not currently on Beijing's official agenda, the temptation seems to be swirling in the heads of China's top brass.

However, achieving the repeatedly stated goal of "reunification" with the mainland might not necessarily involve using force (e.g. a military attack or a blockade). It could also be pursued through intimidation tactics facilitated by military activities. The effectiveness of such tactics is causing concern among analysts, to the point of infusing a sense of unspoken defeatism in their work. This calls into question the usefulness and relevance of their insights.

We prefer to reframe the discussion on sanctions and invite readers to ponder the following: **What would the end of the status quo mean and represent, depending on what might cause that change?**

Without downplaying the provocative and adventurist nature of the possible responses to this question, it seems necessary to challenge the growing feeling of resignation within a significant portion of the Western world based on the unspoken belief that the current status quo is neither sustainable nor manageable in the long run. Because no matter how bold or daring they might seem, there are many reasons for preserving the status quo at all costs:

- There is no doubt that the current status quo is largely upheld by an American "guarantee." However, it could just as well vanish if:
  - This guarantee were to be withdrawn, possibly following:
    - → A change in leadership in Washington (e.g. the return to power of an unpredictable Donald Trump who might be quick to "deal with China");
    - → A cost-benefit analysis by Western nations, informed by the different scenarios mentioned earlier, that arrives at the conclusion that the costs of maintaining the status quo outweigh the benefits.
  - China were to launch an attack on Taiwan, potentially drawing the United States into a war (assuming it stands by its commitment) that could also involve Washington's close regional allies.

Ultimately, any departure from the existing status quo would impact the crucial interests of most participants in the world economy and lead to the risk of a possible nuclear conflict.

- While there has been notable support for Taiwan's democratic progress over the past two decades, it can sometimes seem excessive, overlooking the political system's clear flaws and ambiguities. Nevertheless, it remains that:
  - The Taiwanese society may currently be divided, and the upcoming presidential election campaign in January 2024 is expected to be polarised. But the varying level of commitment among Taiwanese voters to the status quo (and to the way their system of government functions) does not serve as justification for Western countries, who have expressed sympathy for Taiwan's democratic progress, to abandon such a large population to an unpredictable fate, especially given the risk of repression that could be even more severe than the crackdown witnessed in Hong Kong. Even if somewhat idealistic, the idea of having a democratic entity so close to China's shores and existing within a culture largely influenced by China stands as a significant symbol of endangered plurality. If the international community were to accept Taiwan's disappearance as a democracy, a surge of propaganda would undoubtedly ensue, questioning not only the legitimacy of pluralistic political models but also the possibility of having different governance models coexist on the international stage. This would also validate the notion of an inevitable "reversal of political poles," echoing the flawed "end of history" theory that followed the Soviet Union's collapse.
  - The sense of security experienced by Western populations, largely apathetic to Taiwan's fate, stems from their geographical distance from the potential conflict area and widespread ignorance surrounding:
    - → The risks they face if the status quo is challenged and the "reversal of political poles" materialises. To be clear, the danger here is not about enduring physical or material harm but rather the growing influence of a dominant ideology, oblivious to the foundational values of democratic regimes.
    - → The potential role they could play in maintaining the status quo by speaking out, whenever possible, against threats to democratic norms and values.

In summary, a change in the regional and global landscape that currently enables Taiwan to exist as its own entity could come from the use of force or its threat. It could also simply result from the indifference or inability (whether genuine or deliberate) of Western countries to act or respond.

According to the literature mentioned above, sanctions (whether applied as preventive measures or after the fact) might not be sufficient to mitigate the challenges that emerge in the realm of governance, both on a global scale and within the domestic sphere of the "witness" countries. If such sanctions were implemented, they would also have clear and unintended "boomerang effects". These repercussions could lead to re-evaluating the commitment to the foundational pluralism that characterises Western societies and inform Western concepts of how global governance should operate.

VI • Recommendations

The goal is not to adopt postures that would seek to alienate China. Even if a "Global South" is difficult to define, China cannot be excluded from the international community, either in anticipation or in the event of a crisis.

The matter at hand is straightforward. It's not about the so-called "rights of the mainland Chinese population" to decide Taiwan's fate (as wrongly stated by China's ambassador to France). It's about respecting the rights of the people of Taiwan to determine their own future, irrespective of the validity and nuances of the "one-China" principle. To date, there have not been any explicit demands from the Taiwanese population for a vote or a change in status (unlike what has occurred in parts of Ukraine). We need only recall the "One China principle" which can be easily verified by independent observers, possibly appointed by a group of countries outside the UN (since Taiwan does not hold member status). China should want to be part of this group to stay consistent with its own declarations.

It is also important to learn from the experience of Eastern European countries, which have had their share of frustrations with China, having once been part of the Eastern Bloc and the now-defunct “17+1” initiative. This has rendered the idea of a pseudo-alliance with China less relevant. Western European countries could have shown more support for Lithuania during its diplomatic spat with China or the Czech Republic when it hosted Taiwanese officials. However, the stakes are different for countries with less influence in international affairs compared to powers like France or Germany. There’s a delicate balance to be found between appearing submissive or indifferent to China (like Emmanuel Macron’s statements after his visit to Beijing and Guangzhou) and showing the audacity that countries like Lithuania or the Czech Republic have displayed. This entails:

- Urging European companies to increasingly “de-risk,” especially regarding over-investment in China and ill-assessed technology transfers as such dependencies significantly hamper any earnest consideration of sanctions against China.
- Initiating a campaign to heighten awareness and promote civic education among Western audiences. This could involve notifying the general public of concerns raised by institutions that uphold democratic values (as is incumbent upon the administration of any democratic country), such as when Reporters Without Borders, a media watchdog organisation, condemned the United Nations for refusing to accredit Taiwanese journalists to cover public sessions at the World Health Organization assembly in Geneva.
- Fostering awareness that democratic regimes like Taiwan (but ours as well) do not arise or survive serendipitously but also due to sacrifices made at the right time. This entails preparing societies for the possibility of having to relinquish certain comforts in pursuit of alignment with foundational democratic principles. Although Europe’s negotiations on natural resources with Russia during the Ukrainian war showed a lack of strong commitment, this doesn’t mean Europe cannot achieve greater consistency in the future.

A crisis in Taiwan could reveal Europe’s ability to emphasise that, despite their interdependence, Europe and China remain divided by fundamentally different political principles. Before any crisis unfolds, it is essential to underscore that Europe cannot compromise (without actually interfering in the internal matters of a sovereign nation) on principles that define its existence in a pluralistic world, especially in the current context of increasing risks in East Asia.

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At a time when China's political and economic future and its global relationships have never been so uncertain, the Jacques Delors Institute has gathered experts to chart scenarios for 2035 on key issues in Sino-European relations.

The aim is to pinpoint transformative factors and shed light on pivotal decisions to prevent shifts harmful to European interests.

The scenarios are not mutually exclusive for a given issue. They don't follow either a predictable path across different sectors based on whether they predict cooperation or conflict. Rather than searching for broad, overarching narratives, the study reveals a labyrinth of possible interconnections. In this age of de-risking, a one-size-fits-all approach to China is inadequate. Europe must craft tools for a finely tuned understanding of mutual strengths and strategies to prevent systemic rivalry from overshadowing partnership and competition.

EU and China between De-Risking and Cooperation: Scenarios by 2035

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