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LEVERAGING TRADE POLICY FOR THE EU'S STRATEGIC AUTONOMY

ABSTRACT

In a context of increasing weaponisation of interdependence – highlighted by the pandemic and Russia's invasion of Ukraine – Europeans must actively reduce their critical dependencies. The objective of strategic autonomy for the EU is becoming pressing to prevent supply disruptions and ensure the resilience of value chains. While strengthening European production capacities for certain essential goods, this objective of strategic autonomy calls for a shift of European trade policy, which should now be leveraged to secure access to essential inputs when foreign markets are closed. A major turning point has already been reached with the new European level playing field agenda, which is progressively equipping the EU with autonomous defence tools to protect the interests of its businesses. But EU member states are slow to agree on the challenge posed by China, the level of dependence on the Chinese market they are prepared to accept, and the role the EU should play in the context of the US-China decoupling. They also need to bridge the gap between the political rhetoric of reducing European strategic dependencies and the decisions of private companies that have no mandate to secure European supply. Supporting companies' efforts to diversify their supply calls for the EU notably to coordinate more closely with companies to increase collective intelligence on strategic dependencies. It also calls for the EU to promote European standards more actively, to initiate new bilateral negotiations for access to strategic raw materials, and to support an international effort to limit export restrictions.

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STRATEGIC AUTONOMY
pathways to progressive action
SERIES

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Introduction

The rise of "weaponized interdependence" [1] international economics – which has been highlighted by the Covid-19 pandemic and the Russian invasion of Ukraine – makes the goal of the EU's strategic autonomy more pressing than ever. In the field of security and defence, from which the term "strategic autonomy" was originally coined, the war in Ukraine is calling Europeans to strengthen transatlantic security and defence cooperation. But it is even more crucial to increase the resilience of the EU's economy by actively engaging in the avoidance of undesirable dependence and excessive constraints. This aim was a priority of Emmanuel Macron's European policy, and he made it a pillar of the agenda of the French Presidency of the Council of the EU.[2] Today, isolating Russia economically to put pressure on it to end the invasion of Ukraine is a litmus test for the EU's strategic autonomy: it is no longer a long-term goal, but an urgent need.

The ability of the 27 EU member states, in coordination with international partners, to apply unprecedented financial, trade, and individual sanctions in just a few days to support their Ukrainian neighbour and to project democratic values is historic. Europeans surprised themselves. The diversity of measures adopted[3] illustrates the many instruments the EU has at its disposal to defend its interest. The objective of building the EU's strategic autonomy should thus be mainstreamed in all EU policies, as reflected by the now frequent use of a sectorial approach to sovereignty (technological sovereignty, health sovereignty, food sovereignty, etc). But EU trade policy, based on the exclusive competence of the EU, is particularly effective in enabling Europeans to act on the world stage by mobilising the full weight of the single market.

EU trade policy has long been seen as a substitute for an often-failing European foreign policy, hampered by unanimous voting.

1 Farrell, H. and Newman, A. H. (2019) 'Weaponized Interdependence: How Global Economic Networks Shape State Coercion', International Security 2019, 44 (1), pp. 42–79. The authors describe how states with effective jurisdiction over the central economic nodes take advantage of highly asymmetric global networks of information and financial exchange to weaponise these structural advantages for coercive ends.

2 When presenting this agenda on 9 December 2021, rather than using the term "strategic autonomy", France's President Emmanuel Macron referred to "European sovereignty", which is closer to the term "strategic sovereignty" mentioned in the coalition agreement of the new German government, as if he was making a call to move beyond semantic debates to effectively equip the EU with the necessary tools to defend its own interests. Nevertheless, neither of the two concepts has been precisely defined. "European sovereignty" cannot refer to a sovereign EU as the EU does not have the competences to be formally considered as a sovereign political entity. The use of the term "strategic sovereignty" could thus aim at avoiding unnecessary misunderstanding on a teleological interpretation of the EU integration process, while aiming at the same objective as that of the expression "European sovereignty" – a de facto capacity to defend the EU's own interests within the realm of economic affairs (industrial, trade, monetary policies) as well as in a broad range of sectors (technologies, health, food, space, border control, etc).

3 Sanctions range from travel bans and asset freezes targeting individuals or banks, to the removal of Russian banks from SWIFT, import bans on goods and technologies, no access to EU airspace, restrictions on dual-use goods and technology exports, bans on coal imports, suspension of the 'most favoured nation' (MFN) status in the WTO, etc.

However, over the past decade the progressive geopoliticisation of trade has helped blur the line between trade and foreign policy. As Ukraine's allies frame their responses on economic measures to isolate Russia without risking a wider war, the global economic interdependence developed through trade has become the epicentre of geopolitics. In addition to the supply disruptions caused by the pandemic and now war-induced inflation in commodity markets, trade diversion and new risks of supply disruptions make the resilience of supply chains a major security concern.

The focus of this paper is thus on the resilience of European supply chains as a key pillar of the contribution of trade policy to the EU's strategic autonomy. But the need to phase out imports of Russian fossil fuels would also call for a recalibration and acceleration of the contribution of the trade strategy to support the EU green transition.

The key role of trade policy for the resilience and empowerment of the EU – if it is well coordinated with other policies – was already well anticipated by the European Commission's trade policy review of February 2021 entitled 'An Open, Sustainable and Assertive Trade Policy', which set out how trade ceased to be considered as a goal in itself. Rather, it was designed to support other objectives, starting with the green and digital transitions. At this point, however, the updated EU industrial policy strategy had not yet been published. Similarly, the reform of EU competition policy is still in progress. And the lengthy discussion between member states over the right balance to be found between openness and protection of the EU market is now deeply impacted by the decoupling from Russia. While businesses need to adapt to this increasingly conflictual global framework, citizens request national supply of key resources by means of more state intervention and protectionism, although there is a difference across countries within the EU as to the scope of this request. Growing support for 'reshoring'[4] to secure strategic supplies calls for a reassessment of the contribution of trade policy to the goal of the EU's strategic autonomy.

This paper analyses the challenges emerging from the fragmentation of global trade nurtured by a complex overlap of decoupling strategies. It then examines how Europeans can take advantage of the latest adjustments in EU trade policy to strengthen their strategic autonomy, and finally suggests new priorities to leverage the role of trade policy.

4 Reshoring – as opposed to offshoring – refers to the process of returning the production and manufacturing of goods back to the country in which the company was first established.

1. The fragmentation of global trade

The pandemic has raised awareness of the need to find a new trade-off between profitability and resilience. A survey conducted in December 2020 showed that executives strongly support supply diversification as a means to increase resilience.[5] There is not yet significant data on the materialisation of this diversification. But growing geopolitical tensions which would force companies to engage more actively in diversification, notably within South-East Asia or closer to their main market, could have a more decisive impact on the reorganisation of supply chains and could end up in the development of different regulatory silos.

1.1 A decade of 'slowbalisation'

Before the pandemic and the goal of carbon neutrality prompted a renewed consideration of geographical distance in supplier selection, there was already a trend towards 'slowbalisation': not deglobalisation, but a trend of regionalisation with a shortening of value chains for goods between 2012 and 2018 and a reduced contribution of trade in goods to global economic growth.[6]

Several factors have contributed to exhaust the benefits of ever lengthier supply chains which allow firms to specialise in the production stages in which they have comparative advantages, thus creating economies of scale. Amongst them are the rising cost of labour in developing countries (notably in China), sustainability constraints, the 'servicification' of goods (ie, a higher content of services in goods), the digital transformation supporting more 'proximity sourcing', and the development of 3D printing that allows the production of customised goods. 'Nearshoring'[7] has also been supported by the development of robotics, artificial intelligence, 5G, and capital-intensive production.

Yet, today, the geopoliticisation of trade is reshuffling supply chains more decisively.

1.2 The geopoliticisation of trade

Even before the pandemic and Russian invasion of Ukraine the global trade ecosystem had already started to change deeply in recent years. An important turning point in the geopolitics of trade came with the arrival of Xi Jinping as the head of the Chinese Communist Party in 2012. By reinforcing the role of the Chinese government in the economy and encouraging the dominance of state-owned enterprises stuffed with subsidies, Xi led the country to diverge more decisively from global trade rules. Through boosting the economic growth of China and changing the power balance on the global stage, Chinese economic distortions opened up an era marked by more economic nationalism.

However, the European Commission's 2015 EU trade policy review, 'Trade for All', did not yet focus on trade distortions. It only mentioned the need for a "rebalancing" of EU-China relations and a call to "pay particular attention, in trade defence, to subsidisation".

5 Euler Hermes and Allianz (2020) 'Global Supply Chain Survey: In Search of Post-Covid-19 Resilience', 10 December.
6 Altman, S. A. and Bastian, C. R. (2022) 'Trade Regionalization: More Hype Than Reality?' Harvard Business Review, 31 May.
7 Nearshoring refers to relocating the production of goods to within the neighbourhood.

As the EU's main tools at that time to address these issues were anti-dumping and safeguards measures, a reform of the anti-dumping policy was implemented in 2018 to speed up and reinforce anti-dumping proceedings.

The geopoliticisation of trade materialised with US President Donald Trump's aggressive tariff policy and the start of a decoupling of US supply chains from the Chinese technological sector. By engaging in managed trade and by distancing himself from multilateral rules to address the imbalances caused by Chinese state capitalism, Trump created a great deal of uncertainty that has had a negative impact on the global economy,[8] with a slowdown of global growth from 3.3% in 2018 to 2.6% in 2019.

1.3 From a progressive US-China decoupling to a quick fragmentation of global trade

European companies had therefore already started anticipating the need to adapt to this progressive decoupling of US-China supply chains. But in less than a year, global trade has moved more decisively from a rules-based system to a power confrontation that weaponises economic interdependence, thus compelling companies to shift even more quickly from optimal profit to costly security.

In line with the Trump administration, US President Joe Biden has endorsed decoupling as a strategy to rebalance economic interdependence with China and to limit Chinese economic dynamism. However, it is not yet a broad decoupling. As the Chinese economy recovered more quickly than others from the first waves of the pandemic in 2020, the Chinese trade surplus with the US even hit a record 28.7% increase in 2021.

But Washington had by that stage already extended its selective decoupling strategy from the technological sector to the financial sector, with a ban on US investment in a series of Chinese companies and with a delisting of Chinese companies from US stock markets. The explosion of digital trade and the regulatory issues linked to the circulation and storage of data are also fuelling a war of influence in third countries. Successfully promoting digital standards has become both an economic and a political issue since the surveillance of citizens is at stake.

Moreover, it is not just a unilateral US decoupling from China that is taking place, as both countries have taken steps to mutually decouple from each other. Recent Chinese regulatory initiatives mirror US initiatives, with a willingness to decouple from foreign supplies in strategic sectors, in a process of selective closure of the Chinese economy.

China's response to the US Bureau of Industry and Security's Entity List, which restricts exports to certain foreign companies and already includes some 60 Chinese companies accused of supporting Beijing's military activities, was to introduce a similar list in September 2020 (the Unreliable Entity List) and a new export control law that came into force in early December 2020.

Furthermore, while the US launched its Clean Network programme in 2020, restricting the use of technologies and services in US information infrastructures to companies of trustworthy democratic countries, in August 2021 China strengthened its regulations on the security and protection of critical information infrastructures. It imposed data localisation requirements and urged Chinese companies to avoid using foreign technologies to ensure more autonomous and controllable value chains.

8 Giles, C. (2019) 'IMF Slashes Global Growth Forecast on Trade War Fears', Financial Times, 15 October.

Additionally, in June 2021, China responded to US measures that have extraterritorial reach by introducing its own extraterritoriality strategy, which could also target European companies. The assertion of national security concerns in economic policy is even pressing China to aim for more 'self-reliance' in production and consumption, despite the negative impact that this could have on the country's productivity.

India is meanwhile ramping up its effort to curb Beijing's influence in India's technology sector and is urging companies to choose between Chinese growth funds and access to India's vast market. It could well be followed by others, creating a spaghetti bowl of technological standards, with companies forced to navigate between growing firewalls that separate silos of different standards. Companies now increasingly need to anticipate the risk of being exposed to a mounting pressure to align with the political objectives of either Washington or Beijing as the use of extraterritorial and coercive trade measures becomes more widespread.

Despite breaching the core WTO principles of non-discrimination and transparency, the practice of trade coercion has developed, with the notable examples of Chinese sanctions targeting Australia, Canada, and more recently Lithuania. The latter is particularly worrying as China has not only unofficially removed Lithuania from its customs clearance system but extended the sanctions to partners using Lithuanian intermediate goods. This amplification of the impact of sanctions along complex supply chains paves the way to more insecurity in global trade.

Putin's invasion of Ukraine in February has now caused an unprecedented weaponisation of interdependence to isolate Russia from global finance and trade.

Compliance with the sanctions and/or the potential reputational damage arising from consumer pressures has a hefty cost for foreign companies, which were called upon to urgently exit the Russian supply, export, or investment market. The domino effect of sanctions on supply chains is quickly spreading globally with high inflation in commodity markets and transport costs. The loss of overflight capacity in Russian airspace forces all air carriers transiting from Asia to Europe to bypass Russia's huge landmass, and sanctions on sea freight to and from Russia are compounding the bottlenecks caused by the sanctions.

China's response to the war in Ukraine and to a Covid outbreak is meanwhile further speeding up the fragmentation of global trade. Even by sticking to his initial ambiguous posture – increasing bilateral trade that can escape sanctions – Xi Jinping is accelerating the economic decoupling and raising concerns about the need to reduce critical dependencies on China more actively.

Xi intends to support Russia's President Vladimir Putin to preserve his long-term strategic partnership that was signed on 3 February. Entitled 'Russia and China: A Strategic Partnership for the Future', the plan aims at changing the global liberal order.[9]

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9 The global liberal order, which is often referred to as the US-led international order developed since the late 1940s, describes a set of global, rules-based, structured relationships based on political liberalism and economic liberalism, and enshrined in a series of international institutions and agreements to promote global cooperation on issues including security, trade, health, and monetary policy.

But the Chinese economy continues to slow, with a drop in domestic consumption, a persistent real estate crisis, and stubbornness in the zero-covid policy under which major lockdowns deeply impact on supply chains. This is dampening Xi's strategy of Chinese self-reliance and may prevent him from engaging in a more open confrontation with the EU (China's largest trading partner, accounting for 13.7% of the country's international trade) and especially with the US (representing 12.5% of China's international trade), which can use the US instrument of extraterritoriality to fine Chinese companies that do not comply with sanctions.

However, by sticking to his rigid line, Xi is increasing the divide between liberal democracies and autocracies. Furthermore, he is posturing as the leader of the group of countries that have not condemned Russia, and that could join a more open critique of the liberal, law-based international system (starting with the BRICS group, of which China holds the presidency in 2022). At the same time, US Trade Representative Katherine Tai concluded before the Ways and Means Committee in the House of Representatives that "we're feeling increasing senses of insecurity in terms of our supply chains and our reliance on partners who we aren't comfortable relying on", thus indicating that further fragmentation of global trade is expected.

It is still difficult to anticipate the delineation of potential confronting blocs and their internal dynamics. Could the fragmentation of global trade lead to a more integrated bloc of friendly democracies willing to liberalise even further with more regulatory alignment? Would the US, the US plus the EU, or Western countries by and large reduce trade with China and closely affiliated countries, or more broadly with undemocratic countries which represent a large portion of the world's population? Could the current situation even lead to a more brutal fragmentation of global trade, with Western countries suspending the benefits of the WTO's 'most favoured nation' (MFN) status for unfriendly trade partners? Could we ensure the resilience of supply chains in this volatile world of geopolitical rivalries?

1.4 New challenges for the resilience of supply chains in a brutal trade ecosystem

With the pandemic, EU strategic dependencies became tangible. Indeed, the pandemic caused a wave of supply-chain reviews in the world in order to identify such dependencies – on one company or one country – for final or intermediate goods. Beyond current consumption, future needs made possible by innovation also require good anticipation. Today, brutal disruptions caused by exports bans, disinvestment, and related trade diversion can amplify current dependencies, and create new dependencies on components. With dependencies becoming moving targets that are more complex to identify, reducing them is becoming more urgent.

This need to reduce dependencies cannot be summarised as a binary choice between foreign and domestic production. Until now, reshoring has had little apparent economic rationale.

The current hyper-geopoliticisation and fragmentation of global trade today calls for the prioritisation of security at extra cost through the development and expansion of European production capacities for strategic goods – beyond what has already been undertaken with the European industrial alliances to identify investment gaps and pipelines. Security can also be prioritised through Important Projects of Common European Interest (IPCEI) that are focused on batteries, chips, cloud computing, clean hydrogen, microelectronics, and connectivity.

Since the pandemic, companies have advocated diversification and thus open markets. When switching to alternative sources of supply at the end of 2020, less than 15% of companies supported the reshoring of supply chains, while around a third favoured some degree of nearshoring.[10] But given the significant investment needed for diversification as well as for its operating costs, the incentives of companies are mixed. Evidence based on data gathered from French firms finds that, in the context of the early lockdown in China, inventory management was a more effective buffer for the adverse supply shock than the geographic diversification of input sourcing.[11]

As a result, during the pandemic, long-distance trade grew again more than short-distance trade, suggesting that regionalisation is not always the best option to increase the resilience of supply chains and that remote sourcing may also be needed.[12] The continuous increase of the share of services in global trade contradicts the argument of a trend of de-globalisation as well.

While the current surge of Covid in China is again pressing foreign companies to diversify, and while the forthcoming EU due diligence legislation will put pressure on businesses sourcing products from Xinjiang, the fragmentation of global trade, with rising export restrictions on essential goods and with supply scarcity, makes this diversification more urgent and more complex. There was already a global decrease in import facilitation measures for essential goods (food and medicine), without a simultaneous comparable decrease in export restriction measures.[13] Indeed, the US is calling for more restrictions on exports and outbound investment. The European Commission's Chips Act proposal of February 2022 would also allow export restrictions on chips if a supply shortage is anticipated within a member state.

The latest adjustments in EU trade policy nevertheless help to address the paradigm shift in supply chains from 'just in time' to 'just in case', and now to 'safety first'.

10 Euler Hermes and Allianz (2020) op cit.
11 Lafrogne-Joussier, R., Martin, J. and Mejean, I. (2022) 'Supply Chain Disruptions and Mitigation Strategies', Vox-EU/CEPR, 5 February.
12 S. A. Altman and C. R. Bastian (2022), op cit.
13 Evenett, S. (2022) 'Essential Goods Initiative', SGEPT, February.

2. EU trade policy responsiveness

2.1 Trade with European characteristics

The EU continues to have very regional value chains. While the world average share of foreign value-added content in gross exports is around 20%, the EU's share is limited to 11.6%. This is higher than the US share, but similar to that of Japan, and lower than the Chinese equivalent of 16.7%.[14] But the share of extra-regional value added has continued to increase, and to make European value chains more global.[15]

The EU economy also depends more on exports than the US economy. With a ratio of (extra-EU) exports to GDP of 15%, the EU is nearly twice as dependent on exports as the US, which has an exports-to-GDP ratio of 8%.[16]

European exports depend more on China than do US exports. In 2019, 9% of European goods exports, excluding intra-European trade, went to China (vs 18% to the US), while the US exported 6% of its goods to China (16% to the EU).[17] In 2020 China even became the first trade partner of the EU for goods, and the relationship is becoming increasingly unbalanced. Despite a positive trade balance with China in services, and a much smaller trade deficit in goods than that held by the US (which reached 310 billion dollars in 2020), the EU's trade deficit in goods with China continues to grow (181 billion euros in 2020). For European firms, reducing their access to the Chinese market would be costly. The Chinese middle class will likely double to 800 million hyper-connected consumers by 2030, which represents a vital market. The 2021 survey of the European Chamber of Commerce in China (EUCCC) showed that 60% of European companies in China planned to invest more in the Chinese market (up 4% from the 2019 pre-Covid survey).[18] These companies also face competition from US companies, which similarly do not intend to give up the Chinese market (especially in the automotive, consumer goods, consulting, and financial sectors) – a market without which European companies would struggle. The survey of the American Chamber of Commerce in Shanghai conducted over summer 2021 concluded that 60% of the more than 300 American companies operating in China reported increased investment compared with 2020. Of these, 72% had no plans to move production out of China in the next three years and no company had relocated their production from China to the United States.[19]

Before the Russian invasion of Ukraine, the EUCCC had already suggested that European companies in China, notably in the information, communications, and financial services sectors, would have to segment their offerings and processes between the US and China.

14 OECD (2018) TiVA database.
15 Miroudot, S. and Nordström, H. (2020) 'Made in the World? Global Value Chains in the Midst of Rising Protectionism', Review of Industrial Organization, vol. 57, no. 2, September, p. 215. European manufacturing sectors (with computers, electronic and electrical equipment at the top) are generally more reliant on foreign value-added content than service sectors, even if domestic sourcing is the norm for both.
16 Calculations are based on data for 2019 from the WTO for merchandise exports and from the World Bank for GDP.
17 IMF data, 2020.
18 EUCCC (2021) 'Business confidence survey'.
19 Huang, T. and Lardy, N. R. (2022) 'Foreign Corporates Investing in China Surged in 2021', PIIE, 29 March.

It suggested they would thus have to choose between Chinese or US technologies to make sure of compliance with country-specific standards and norms. Depending on their share of global sales in China, European companies could opt between a 'dual system' setting up a specific supply chain and R&D for the local Chinese market in parallel with the system for the rest of the world, and a 'flexible architecture' system, maintaining international operations with value chains that cover China and the rest of the world, locating in China only what is strictly necessary to comply with new Chinese legislation.

This partial or complete duplication of supply chains aims at keeping access to both markets. But in the post Russian-invasion era, alliances of like-minded countries could develop. If smaller countries, especially in the neighbourhood, were pressured to align themselves with the regulations of one of the major trading powers, the management of supply chains for intermediate goods would become more challenging. Indeed, this more adverse international framework for an open economy that is highly integrated in international trade has accelerated the building of EU strategic autonomy.

2.2 The taste of strategic autonomy

The cohesion of the EU member states in the face of Trump's aggressive unilateral tariff policy had already strengthened the confidence of Europeans in their ability to demonstrate strategic autonomy even before the pandemic and Russia's invasion of Ukraine. Indeed, EU member states gained credibility with their swift and proportionate response to Trump's steel and aluminium tariff hike. They also succeeded in putting in place a strategy of deterrence against the US threat of high tariffs on car imports. This increased EU assertiveness undoubtedly paved the way for a strong response to the Russian invasion.

While the Trump administration has made the US a less reliable partner, especially as the country continues to block the Appellate body of the WTO dispute settlement mechanism (DSM) by vetoing the appointment of new judges, the EU has adopted its own level playing field agenda in favour of a rules-based system. Far from what is commonly described as a 'naïve' Europe – an open Europe without a defence – the EU has remained committed to its multilateral doctrine, while developing autonomous defence instruments to protect the single market from trade distortions that have not yet been addressed by the WTO.

2.3 Not giving up on multilateralism

The defence of existing multilateral rules remains a pillar of EU trade policy as non-discrimination and transparency have provided stability for global trade. The EU therefore addressed the blockage of the WTO's Appellate Body by actively supporting the establishment, in March 2020, of a Multiparty Interim Arrangement (MPIA) that provides access to an independent appeal process, and thus preserves the efficacy of the DSM between the members of the WTO that support the MPIA – including China.

The US seems to aim at a return to the WTO's General Agreement on Tariffs and Trade (GATT), under which there was no binding nature for the parties to the dispute. But the EU continues to pressure Washington to engage in a reform of the Appellate Body to preserve the framework of the existing rules. Recent European complaints sent to the WTO in February 2021 about China's sanctions targeting Lithuania, and China's irregular use of EU patents, underline the importance of multilateral rules and of a functioning dispute settlement mechanism.

The current Western sanctions against Russia, as well as the suspension of Russia's MFN rights by the countries of the G7, have also been implemented in reference to Article XXI(b) of the GATT allowing action to be taken to protect essential security interests.[20]

In addition to the new common trading rules needed for sectors that are expanding (eg, e-commerce, climate change response, investment, etc), the EU calls for the closure of loopholes in the multilateral rulebook that allow trade distortions and create global imbalances.[21] However, the Russian invasion of Ukraine unfortunately reduces the prospect of bringing the US and China to the negotiating table, and their bilateral relations continue to be managed essentially outside the WTO, through their bilateral Phase One agreement. The 12th Ministerial Conference of the WTO in June 2022 ended with unexpected positive outcomes regarding notably fishery subsidies, the moratorium on electronic transmissions, a waiver of certain requirements concerning compulsory licensing for Covid-19 vaccines or limitation of export restrictions for food purchased for humanitarian purposes. But the postponement of the WTO reform to future negotiations is disappointing and the reluctance of the US and China to engage in this reform leaves little prospect of a meaningful progress in the short term.

There could also be more impetus in the future for building alliances between like-minded countries, like the plurilateral initiative launched between the EU, the US and Japan in January 2020 to reduce industrial subsidisation and increase pressure on China to limit its distortive subsidies. However, countries such as India and South Africa which have proved to be hard negotiators, remain firmly opposed to plurilateral formats although the latter remain open to additional members ready to join.

In retrospect, the EU's anticipation that it would be more effective in supporting multilateralism if it reinforced its autonomous capacity to defend a level playing field seems even more accurate now.

2.4 A level playing field agenda based on autonomous defence tools

Protecting EU businesses from trade distortions, such as unlimited subsidies or asymmetry in access to public procurement, was high on the list of objectives of the European Commission's 2019 Strategic Outlook on EU-China relations. Furthermore, the Commission created the position of the chief trade enforcement officer (CTEO) in 2020 to monitor a better implementation of trade agreements given that grasping their full benefit would increase the legitimacy of the EU's trade policy. One of the decisive contributions of the Commission's 2021 trade policy review was to present a fair competition strategy that allows the EU to act proactively.

20 The 2019 WTO Panel ruling on 'Russia – Measures Concerning Traffic in Transit' (WT/DS512/R), which related to restrictions imposed by Russia on the flow of traffic in transit from Ukraine, was the first to provide an interpretation of "essential security interests". While the Panel found that it did have jurisdiction to review a WTO member's invocation of the national security exception, the assessment of the legitimacy of discriminatory measures applied in the name of "essential security interests" will continue to cause legal dispute.

21 European Commission (2021) 'Reforming the WTO toward a sustainable and effective multilateral trading system'.

The strategy is not only about offsetting the negative impact of trade distortions, but is about being able to act preventively with autonomous defence instruments that signal to third countries what they are exposed to if they do not respect fair competition.

This change in the EU's stance on trade defence was initiated by the implementation of the foreign direct investment control mechanism in October 2020 to protect Europeans strategic assets from predatory investments. Since then, the Commission has also proposed other tools to complement the EU's toolbox, all supporting trade based on the WTO rules of non-discrimination and proportionality. The fear of several member states that these tools could be used for protectionist purposes and could reduce the attractiveness of the single market led to lengthy negotiations on their calibration to ensure their effectiveness against trade distortions. But as Dutch Prime Minister Mark Rutte – an active proponent of an open economy – acknowledged on 9 March 2022, the Russian invasion is a "final warning" to reinforce the French vision of open strategic autonomy to "defend" the EU:[22] more protection without protectionism. The agreements now reached during the French presidency of the Council of the EU for three additional tools tend to signal more cohesion of the 27 EU member states on this objective.

- **The international procurement instrument (IPI)** aims at pressuring third countries to open their public procurement to introduce reciprocity with the EU public procurement market, which is one of the largest and most accessible in the world. The value of EU public procurement contracted notably to China jumped from €750 million in 2019 to €2 billion in 2020, while China ranked second (after the US) as the main non-EU contractor of EU public procurement for the period 2016-2019.[23] The IPI now empowers the EU to initiate investigations in cases of alleged restrictions for EU companies in third country procurement markets, engage in consultations with the country concerned on the opening of its procurement market, and ultimately restrict access to the EU procurement market for foreign companies (by applying score adjustment measures or excluding third country bidders) if they come from a country which continues to apply restrictions to EU companies. The balance struck between the coverage of the instrument and the burden it places on contractors and bidders will allow more than 70% of the public procurement value in the EU to be covered.

22 Speech by Prime Minister Mark Rutte at Sciences Po in Paris about the current developments in Ukraine, 9 March 2022. It should, however, be noticed that Rutte insisted on an "open" strategic autonomy of the EU, while Emmanuel Macron is known to refer to the "strategic autonomy" of the EU, although he recently referred to an open Europe in his speech at the closing ceremony of the Conference on the Future of Europe at the European Parliament in Strasbourg, on 9 May 2022.

23 Sartori, E. (2021) 'EU-China Trade – Levelling the Playing Field at Last?' MERICS, 28 September; European Commission (2021) 'Study on the measurement of cross-border penetration in the EU public procurement market', p. 141.

- **The carbon border adjustment mechanism (CBAM)** – covering carbon-intensive iron, steel, aluminium, cement, fertiliser, and electricity – will equalise the price of carbon between imports of these products and domestic production of the same, and will ensure that the EU's climate objectives are not undermined by the relocation of production to countries with less ambitious policies than those of the EU. Used as a climate measure to incentivise third countries to engage in the fight against climate change, the CBAM will support a more level playing field.

- **The mechanism to control foreign subsidies within the single market** will allow the final investor to be identified and will thus prevent a foreign competitor from benefiting from the distorting advantage of unlimited state aid. The instrument targets subsidies resulting from the export restriction of raw materials which thus provides local producers with access to cheaper raw materials. It also targets transnational subsidies (such as preferential loans, short-term credit lines, and equity injection) that are granted to the producers of the exporting country by another foreign country, such as China.

Current events could help speed up the conclusion of a new agreement before the end of the year.

- **The anti-coercion instrument (ACI) might prove to be the most decisive tool** of all if it effectively shields the EU and its member states from the diversification of modes of economic coercion (from regulatory initiatives to less traceable and even silent modes of coercion using, as in the case of China, the leverage of state control over private companies, or using the responsiveness of Chinese consumers to the PRC's positions), and from the multiplication of countries engaging in economic coercion.

  For example, the waiver on export restrictions negotiated by the EU with the Biden administration in the framework of the decoupling from Russia does not shield the EU from potential extraterritorial sanctions implemented by future US administrations. China is meanwhile increasingly using coercion via trade networks, while Russia responded to Western sanctions with exports bans on an extensive list of more than 200 products, and with gas bans that already target countries like Bulgaria and Poland. Other third countries may furthermore align to increase the leverage of coercion. The calibration of the ACI is key as it is designed to be a deterrent whereby the application of countermeasures remains a last resort. Regardless of the involvement of stakeholders, the margin of appreciation given to the European Commission to assess the wide range of possible triggers and countermeasures is decisive. The credibility of deterrence lies in the political character of the final decision which is to be based on the "Union interest" – indeed, only a reverse qualified majority vote could prevent the adoption of the final decision. Defending the interest of the EU through this instrument would therefore engage Europeans in a more ontological process of asserting who they are, who they want to be on the global scale, and how they should recalibrate their current position towards China.

The US is following the same trend. In May 2021, US Trade Representative Katherine Tai called for the adoption of new defensive tools to deal with the prospective damage to American businesses from foreign competition, and to move beyond the mere use of responsive countermeasures. More recently, on 25 March 2022, she stated that the US will be increasingly active in pressuring China to change trade distortive practices.

Indeed, on 31 March 2022 the WTO's Committee on Market Access received numerous complaints from Australia, the European Union, the United States, the United Kingdom, Canada, New Zealand, and Japan against Chinese coercive practices.

Another important pillar of the EU's strategic autonomy is the reduction of dependencies on critical goods imports.

2.5 Critical dependencies and diversification

The stress test of the pandemic revealed a strong resilience of global supply chains. The supply chain disruption that occurred at the start of the pandemic for specific products such as personal protective equipment was due to an unprecedented global demand shock, rather than to the weaknesses of supply chains. But the disruptions were a wake-up call to acquire more knowledge on critical dependencies and actively reduce them.

In the field of critical raw materials (CRMs), the Commission started to draw up a list as far back as 2008, and then updated it every three years to take account of any changes in production, markets, and the needs created by technological innovation. The most recent update in 2020 included 30 CRMs.

Yet the Commission's 2021 trade policy review only refers to a forthcoming broader assessment of EU critical dependencies, and just mentions the contribution of bilateral trade agreements to access raw materials.

Rather than presenting a strategy to effectively reduce strategic dependencies, the review underlines the conditions allowing for the diversification of supplies. Above all, it makes the case for an "open strategic autonomy", with a clear distinction between strategic autonomy and autarchy. In the post Russian-invasion era, a robust industrial policy is greatly needed to build up strategic, domestic production and reserves. But the objective cannot be to produce everything domestically. There are limits to reshoring. Instead, the strategic autonomy remedy is meaningful for targeted strategic products for which Europeans have identified an over-reliance on one country or producer. Yet beyond the most obvious strategic products (batteries, chips, and other high-tech goods), it remains challenging to identify the main risks and potential shortages of critical products.

The Commission's first assessment, published in May 2021, focused on four strategic ecosystems (defence and aerospace; energy intensive industries; renewables, digital and electronics; and health) which were scrutinised on the basis of three key indicators: concentration of production,[24] importance in EU demand, and domestic capacity to substitute imports.[25] It concluded that the EU has a high dependency on 137 imported products, with little capacity to substitute 34 of them, representing respectively only 6% and 0.6% of the value of EU imports. The EU's dependency on Chinese imports for the 137 identified items is as high as 52%.

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24 A forthcoming publication from CEPII (Jean, S., Reshef, A., Santoni, G. and Vicard, V., 'The Global Concentration of Exports: Monopolized Products in China') shows that of the 520 products for which a single exporter accounted for more than half of world exports in 2018, 320 were from China.

25 European Commission (2021) 'Strategic Dependencies and Capacities', SWD/2021/352, 5 May. The dependence is measured by using three key indicators: concentration of production, importance in EU demand, and EU capacity to substitute imports.

A working paper published by the Commission on 22 February 2022 has enlarged the assessment to new areas (rare earths and magnesium, chemicals, photovoltaic panels and technologies, cybersecurity technology and capabilities, IT software). The reduction of dependencies on critical raw materials imports is unlikely to be achieved by reshoring. Rebuilding domestic production for some critical goods is costly, and furthermore may justify using more robotics and other automation technologies to compensate for the cost of reshoring. Businesses therefore tend to favour diversification, adding an alternative supplier (the so-called 'China + One' strategy). Indeed, they are only likely to opt for EU production if the conditions are attractive – in other words, if a close coordination of several policies (on research and innovation, industry, competition, and trade) supports fairer competition, and if there is active use of the new autonomous trade defence instruments.

With regard to the initial list of critical imports, trade interdependence with China remains important to keep the country engaged in globalisation and prevent a more radical turn towards autarchy, which could fuel a more aggressive international posture. Nevertheless, the Russian invasion of Ukraine shows that the EU must also be ready for a more painful reduction of its over-reliance on Chinese factories for a wide range of low-tech products in the event of a more brutal confrontation with China. The appetite of businesses for decoupling is not yet in line with this political anticipation of a potentially brutal decoupling. Indeed, businesses have limited national allegiance and tend to address their customers' demands and their shareholders' concerns rather than citizens' needs.

For businesses, handling the cost of broader diversification to anticipate a potential, brutal decoupling would require much more awareness of the increasing geopolitical risks among European consumers, and much more awareness of the need to defend the "EU interest".

If Russia served as a catalyst for a better understanding of the EU interest, the response should be a more active diversification which would mean keeping the European market open, rather than deglobalisation. Without solving the persistent problem of the unequal distribution of trade benefits, this reorientation of trade towards greater resilience gives new legitimacy to EU trade policy, but also demands additional initiatives to provide more incentives for diversification.

3. Increasing the leverage of trade policy for the EU's open strategic autonomy

Diversification as a principle works well. But the EU is not a unitary state which can easily engage in managed trade. Companies are in the driver's seat, and they focus on what they can control – notably, increasing their agility to respond to a crisis – rather than properly anticipating risks and taking measures to cushion them. The European Commission thus has a key role to play in creating the conditions for diversification, starting with the provision of adequate data for companies to be able to anticipate geopolitical risks, and to develop knowledge on critical dependencies that goes beyond EU-aggregated customs data.

3.1 Increase the capacity of the EU to monitor critical dependencies

Companies can assess the vulnerability of their direct supplier upstream and direct client downstream. But few extend resilience planning further upstream than to their second- or third-tier suppliers. They lack a holistic view of the entire supply chain, which could enable the traceability of risks. Nor do they have any incentive to consider the impact of their decisions on third parties, which makes the systemic resilience of supply chains difficult to manage.

The European Commission has not yet provided details on its future Single Market Emergency Instrument (SMEI) that is planned to be better anticipate and react to the next crisis which may cause major shocks to demand or supply within the single market and notably to address EU's structural strategic dependencies. But given the reluctance of private companies to share data, the Commission should actively work on providing a bird's eye view of collective intelligence on critical dependencies at the European level, and even at the global level.

It is challenging to identify the kind of information required and to build confidence in sensitive data-sharing systems. Building on the experience of controlling exports of personal protective equipment to ensure supplies to all member states during the pandemic, the Commission could collect data from companies on their production processes, stocks, and supply chains. Blockchain technologies could contribute to building trust among stakeholders. All actors belonging to a common industrial ecosystem (large companies, subcontractors, research laboratories, universities, or others) could be encouraged to send alarm signals whenever they identify the risk of a supply shortage. Further due diligence on the monitoring of dependencies could also be requested from lead firms to increase the macro-prudential management of risks along the supply chains.

3.2 Restoring the ability of Europeans to ratify new trade agreements

With more than 40 trade agreements signed worldwide, the EU is the trade power which has sealed the highest number of such agreements. EU companies benefit from this comparative advantage and are now calling for the negotiation of new agreements in support of their diversification efforts – to ensure, for example, that there is no discrimination in access to raw materials. Notably, they are therefore calling for a reduction in the EU's massive dependency on imports of rare earths, which are used intensively for green and digital technologies. A total of 95% of the supply of rare earths comes from China, and the same country provides 85% of the world's processing capacity. While European demand for rare earth metals will double by 2030, in early 2021 China was already mentioning potential bans on exports, such as the ban it applied to Japan in 2010.[26] Beyond building stocks and improving recycling, important research and innovation is required to reduce pollution from the extraction and processing of rare earths. This would in turn increase the social acceptability of mining and allow for the relocation of extraction facilities to Europe or third countries whenever resources are available.

Accessing raw materials is a key objective of the EU's negotiations with Australia and Chile. The latter is the world's largest producer of lithium and supplies 78% of the EU's lithium needs for batteries. A new trade and investment agreement was concluded with New Zealand on 30 June 2022. But there is growing concern about the challenge of ratifying agreements that have already been concluded – such as the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada which provisionally entered into force in 2017: the trade agreement reached in principle with Mexico in April 2018; the trade agreement that the EU signed with the Mercosur states (Argentina, Brazil, Paraguay and Uruguay) in 2019; and the Comprehensive Agreement on Investment (CAI) that the EU concluded in principle with the People's Republic of China in December 2020.

The reluctance of European public opinion to support new ratifications is concerning, especially given that the Biden administration has ruled out further negotiations on trade agreements and that China is consequently filling the gap. China already has 18 free trade agreements (FTAs), including regional agreements like China-ASEAN and the Regional Comprehensive Economic Partnership (RCEP).[27] Furthermore, China is intensifying negotiations for eight additional agreements on top of its application to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).[28]

The Commission's 2021 European trade policy review suggests more nearshoring with the Balkans and Middle Eastern and North African countries. But while China is increasing its grip in South-East Asia, Africa, and Latin America, this also entails it dealing with remote and reliable partners of the EU in these regions. 'Friend-shoring' production away from China may not be limited to creating a club of democracies. Countries qualifying as like-minded allies of the EU would first of all be countries that respect the rule of law.

Advocating the negotiation and ratification of new trade agreements has therefore become a question of security of supply rather than profit maximisation. It requires political leaders to invest in a pragmatic and responsible discourse

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26 Fabry, E. (2021), 'Reducing the EU's High Dependency on Imports of Chinese Rare Earth and other Strategic Minerals', Building Europe's strategic autonomy vis-à-vis China, Report No. 124, Jacques Delors Institute, pp. 117-123.

27 RCEP was signed between the 10 ASEAN member states (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) and Australia, China, India, Japan, South Korea, and New Zealand. It entered into force on 1 January 2022.

28 After the Trump administration withdrew the US from the Trans-Pacific Partnership (TPP) in 2017, the final free trade agreement CPTPP was concluded between 11 countries in the Asia-Pacific region (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam) and entered into force in December 2018.

Promoting European standards

The EU is a normative power. The "Brussels effect", as branded by the Finnish American lawyer Anu Bradford, refers to "the EU's unilateral ability to regulate the global marketplace" [29] with third countries aligning with the single market standards. But competition is becoming fiercer in the field of digital standards and the EU's ability to promote its own standards in this area will be crucial for its strategic autonomy. China, which still accounts for only 1.8% of international standards, has strong ambitions in this area, especially for 5G technology and artificial intelligence.[30] It is therefore investing considerable resources to increase its influence in European and international standardisation bodies, while also developing an offensive strategy to promote its standards along the Silk Roads, which has unlimited geographical reach. The EU must adapt its standardisation strategy to the resources invested by Beijing. Beyond the mobilisation of European companies within standardisation bodies, according to their market shares and means, Europeans would gain from developing a more offensive common strategy to promote European standards within international bodies, and increasing cooperation in this field with Asian, African, and Latin American countries while ensuring better control of the conformity of their imports with these standards.

The new Standardisation Strategy presented by the European Commission on 22 February 2022 rightly aims to strengthen coordination between EU member states and like-minded partners. The funding of standardisation projects announced in African and neighbourhood countries should nevertheless be extended to remote areas such as Latin America and South-East Asia.

The EU should also not rule out joining the CPTPP agreement signed by 11 countries in the Pacific region, which will carry weight with common standards. This could be a powerful instrument to influence Chinese trade practices.

The Russian invasion of Ukraine gives a fresh geopolitical dimension to the Trade and Technology Council (TTC) launched between the US and the EU in September 2021. The focus of each of the TTC's ten working groups is key for the EU's strategic autonomy.[31] The two partners have as many incentives for cooperation as for competition. But, in addition to resolving historical disputes, the TTC provides a unique platform to discuss issues of common interest, including the new geopolitical incentive for the development of common standards, notably digital standards that safeguard political rights. Above all, the TTC should already make it possible to coordinate the measures adopted on each side to address Chinese trade distortions, in line with the waiver that has already been negotiated in case of discrepancies between EU and US sanctions on Russia.

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29 Bradford, A. (2020) The Brussels Effect. How the European Union Rules the World, Oxford: Oxford University Press

30 Bondaz, A. (2021) 'Bolstering Europe's Normative Power Amidst China's Global Ambitions in Technical Standards', in Bermann, S. and Fabry, E. (2021) Building Europe's strategic autonomy vis-à-vis China, Report No 124, Jacques Delors Institute, December, p. 64.

31 The ten working groups include the following topics: technology standards cooperation, climate and clean tech, secure supply chains, information and communication technology and competitiveness, data governance and technology platforms, misuse of technology threatening security and Human rights, export controls cooperation, investment screening cooperation, promoting small and medium-sized enterprises access to and use of digital tools, and global trade challenges.

The inclusiveness of the agreements delivered by this cooperation would furthermore be decisive in promoting a rules-based world order and in keeping the US engaged in multilateral negotiations.

Despite not having the same ambitious coverage as the Transatlantic TTC, the launch of an EU-India TTC announced in April 2022 by President of the European Commission Ursula von der Leyen also signals a more active promotion of EU standards in the Indo-Pacific.

3.3 Anticipate the spillover impact of export restrictions

Russia's violation of international law legitimises the use of trade and financial restrictions by Western allies without mitigating the negative domino effect of these restrictions on European and global supply chains, as seen with commodities. These measures have a different legal basis (GATT Article XXI) from export restrictions aimed at securing national/European supplies of raw materials (GATT Article XX), or from coercive restrictions contrary to WTO rules. But a scenario of the proliferation of increasingly informal Chinese coercive measures and/or export restrictions around the world to secure strategic supplies should be carefully anticipated. All of these measures and restrictions can have a negative viral effect on international supply chains, with market prices that are difficult to control. This would further amplify supply problems and could notably lead to a major risk of food scarcity.

The EU should call for the continuation of the WTO Secretariat's work on mapping export restrictions on Covid-related materials,[32] extending it to export or import restrictions worldwide to ensure greater transparency and to better anticipate their downstream impact.

32 WTO (2022) 'Summary of export restrictions and trade easing measures relating to the Covid-19 pandemic', G/MA/W/168/Rev.2, 29 March.

Conclusion

The new focus of EU trade policy on a level playing field and the strengthening of the resilience of value chains is an important pillar of the EU's strategic autonomy. With its autonomous trade defence toolkit, the EU is equipping itself with the means to be more offensive in defending its interests and keeping its market open.

However, the use of the instruments in this toolkit will be determined by the ability of member states to agree on the type of challenge posed by China, the role they wish for the EU in the context of the decoupling of the US from China, and thus the level of dependence on China that they are prepared to accept. The Council and the European Parliament should actively engage in developing a common European vision towards China. While keeping China engaged in globalisation to avoid a more self-sufficient China to become more aggressive, the EU needs to rebalance its interdependence with China. It thus needs to identify areas where China can increase its need for European supplies, and to reduce some of Europe's overdependence on Chinese supplies so that Europeans are credible in their willingness to do without if a security imperative compels them to do so. This clarification of the EU's interest is urgently needed ahead of a strategic rapprochement with the US triggered by the war in Ukraine.

Furthermore, there is a lag between the political rhetoric of reducing European strategic dependencies and the strategic decisions of private companies that do not have a mandate to secure European supply. The EU could help companies to better assess geopolitical risks and the need to diversify their supply by setting up a secure system for collecting information on critical dependencies along supply chains.

While there are incentives for reshoring a meaningful capacity of production for some strategic products, including rare earth extraction and processing, the diversification of production will require additional trade negotiations that secure non-discriminatory access to foreign markets and a more active promotion of European standards.

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STRATEGIC AUTONOMY
pathways to progressive action

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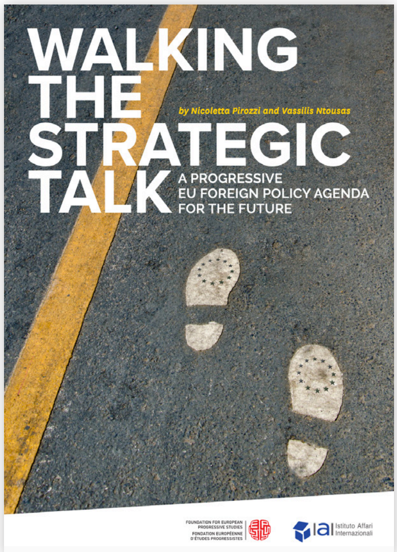
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