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The EU and China in 2020: More Competition Ahead

ERIK BRATTBERG AND PHILIPPE LE CORRE

INTRODUCTION

The year 2019 was momentous for EU-China relations, marked by a tougher EU approach toward China. The year 2020 will likely be just as consequential and even more confrontational. Several major tests and roadblocks are expected during the next several months, including whether the EU and China can agree on a bilateral investment agreement and whether European governments give the Chinese company Huawei contracts for building out 5G networks. Yet, despite the more assertive European approach, the EU remains keen on maintaining cordial relations with Beijing and ensuring strong continued business ties.

A TURNING POINT IN EU-CHINA RELATIONS: 2019 IN REVIEW

A new, more assertive European line toward China surfaced in a January 2019 [policy paper](#) on EU-China economic relations from the influential Federation of German Industries (BDI). The paper referred to China

as a “systemic competitor” and called on the EU to strengthen its commitments to compete with China. The paper expressed growing frustrations among German businesses about China’s ability to reform its market-distorting practices. It also urged German politicians to support tougher measures against China. Yet, because many major German multinational corporations such as Siemens and Volkswagen still see China as an important export market, the paper also raised many eyebrows in Beijing, showing growing tensions between the two markets.

A More Assertive EU Strategy

Reflecting the general mood of the BDI paper, the most significant update of the EU’s own thinking on China came on March 12, 2019, when the European Commission and the European External Action Service jointly put out a [policy paper](#). This paper was striking for at least two main reasons. First was the speed and unusual way by which it came about. The process was driven by outgoing European Commission President Jean-Claude Juncker, who teamed up with German Chancellor Angela Merkel



and French President Emmanuel Macron in an effort to beef up the EU's common position on China ahead of crucial meetings that year. Even more striking was its bluntness, which is rare in official EU documents. For example, a key sentence referred to China as “a negotiating partner with whom the EU needs to find a balance of interests, an economic competitor in the pursuit of technological leadership and a systemic rival promoting alternative models of governance.”

The unprecedented use of the term “systemic rival” reflected growing impatience in EU circles with China's failure to open its markets to European companies in key sectors. The paper called for a “flexible and pragmatic whole-of-EU response” and greater European access to the Chinese market. It concluded with ten action items that the European Council quickly endorsed. The significance of the strategic outlook on China should not be underestimated. Its timing and strong language helped give the EU concrete leverage when dealing with China during a crucial stage, while avoiding having to resort to confrontation or containment. The message was not lost on Beijing, which quickly drew the conclusion that it could no longer take the soft European position for granted. Beijing had to redouble its efforts to fulfill at least some of its commitments lest Brussels follow Washington in taking a more stringent approach.

Immediately after the strategic outlook paper was released, Juncker, Merkel, and Macron met jointly with Chinese President Xi Jinping during his visit to Paris on March 25, 2019. By extending an invitation to the German chancellor and the head of the commission to attend the meeting with Xi, Macron signaled that he wanted to build a core coalition within the EU to gain leverage over Beijing. During the meeting, Macron and Xi released a [joint statement](#) calling on Europe and China to work together in a number of areas, such as the economy, global governance, and climate. However, [Macron also cited](#) frank discussions with his Chinese counterpart on human rights issues. Xi's visit to Europe

included time in Italy where the two countries agreed on a [memorandum of understanding](#) on the Belt and Road Initiative (BRI). This represented a major symbolic win for Beijing, as Italy was the first G7 nation to endorse China's flagship infrastructure initiative.

Around the same time, the European Commission released a number of [recommended measures](#) to address 5G security concerns. Following a request from the European Council for a concerted European approach, the commission drafted a plan of legislative and policy instruments essentially involving three steps: a national 5G security risk assessment in each of the member states, a coordinated European-level assessment, and a common toolbox of mitigating measures to address identified risks. The [report](#) on the coordinated risk assessment produced by the commission's NIS Cooperation Group was released on October 9, 2019. On December 3, 2019, the [European Council endorsed](#) the findings and urged all member states to develop responses.

Finalizing the EU's Investment Screening Mechanism

On April 10, 2019, the [EU finalized](#) an investment screening mechanism that marked a major step forward in forging a more coherent, common EU approach toward detecting and raising awareness around foreign direct investment (FDI) from China in critical assets, technologies, and infrastructure. Under the new rules, foreign investments in several critical sectors—such as energy, ports and airports, communications, data, space, and financial industries—will be scrutinized. This was a major breakthrough for the EU after a number of free-market countries, including Germany, the Netherlands, the Baltics, and Scandinavia, decided to support the initiative. When the screening mechanism enters into force in late 2020, the commission will be able to request information and issue a nonbinding opinion on a specific foreign investment in an EU country. Greater coordination and information sharing between the

commission and member states is also expected. The EU mechanism will set minimum requirements for national mechanisms, but it falls short of harmonizing existing measures. Currently, about half the member states have some type of national screening legislation in place, but they often differ substantively.

Crucial EU Wins at the EU-China Summit

The timing of the EU investment screening mechanism—right before the annual EU-China summit in Brussels on April 9, 2019, between the EU leadership and Chinese Premier Li Keqiang—was unmistakable. Question marks surrounded the summit, especially regarding whether the two parties would agree on a joint statement (they had twice failed to do so in 2016 and 2017). In the lead-up to the summit, it was clear that the EU was going to play hardball, taking advantage of China's desire to be more accommodating toward the EU in the midst of a growing U.S.-China trade standoff under U.S. President Donald Trump. In the end, a [joint communiqué](#) was agreed upon in the last minute. China committed itself to the World Trade Organization (WTO)'s plurilateral Agreement on Government Procurement, and it vowed to address forced technology transfers and industrial subsidies. The most significant outcome of the summit, however, was an agreement to finalize an EU-China Comprehensive Investment Agreement (CAI) by 2020. From the perspective of EU leaders, the summit was a relative success given Beijing's willingness to commit to several of the EU's top priorities.

Right after the summit in Brussels, Li continued to Dubrovnik, Croatia, for the annual 16+1 forum (April 10–12, 2019) with eleven Central and Eastern European EU member states and five non-EU Balkan countries. (At the event, Greece became a full member, so the forum is hereafter referred to as the 17+1.) The sequence of the two summits was intentional: In 2018, the forum occurred *before* the EU-China summit,

leaving EU leaders frustrated that the 17+1 format was serving as a vehicle for Beijing to undermine European unity on China. To allay this concern, set a positive tone for the forum, and potentially get China to commit to more, the EU managed to get 17+1 scheduled to follow the summit last year.

Changing European Views of the Belt and Road Initiative

Two weeks after the 17+1 forum, Beijing itself played host to the second Belt and Road Forum, with several European leaders in attendance. Europe's own view of the BRI has been mixed from the beginning. During the first Belt and Road Forum in 2017, EU leaders surprised their Chinese hosts by refusing to explicitly endorse the initiative. Since then, the EU has remained fairly [cautious and apprehensive](#) about Beijing's intentions and about how some BRI projects are being implemented, especially in vulnerable Balkan countries. Around half of the EU's member states—including Greece, Hungary, Italy, and Portugal—have broken ranks and endorsed the BRI. Reflecting growing European hesitations about the Chinese initiative and the need to provide an alternative, the EU released its own [strategy for connecting Europe and Asia](#) in September 2018. And in a landmark development, at the first-ever EU connectivity forum in Brussels in early September 2019, the [EU and Japan signed an agreement](#) to coordinate more on transport, energy, and digital infrastructure projects linking Europe and Asia based on sustainability, quality infrastructure, and a level playing field.

The year ended with a high-profile visit by Macron to China in early November. Macron's trip was noteworthy because he brought along with him an Irish European commissioner and the German education minister. This was seen as a response to Merkel, who had previously received some criticism for not bringing any other European officials with her on her trip to China in



September. More noteworthy, Beijing committed to signing an [agreement](#) with the EU on geographical indications. This was seen as victory for the EU and a sign that China was committed to deliver on at least some of the commitments it had made during the most recent EU-China summit.

FURTHER COMPETITION AHEAD

The upcoming year is likely to be even more challenging for EU-China relations. The EU-China debate will be dominated by tough issues such as negotiations over a bilateral investment agreement and European decisions over 5G. The question is whether Europe will be able to build on some of the isolated successes it had in 2019 to push China into making further compromises and delivering on its previous commitments or whether the Chinese side will push back more and, if so, how the EU will respond in turn.

Three Major Summits

Aside from occasional one-on-one meetings between Chinese and individual European leaders, the Europe-China agenda in 2020 will be largely shaped around three summits. The first one is the regular EU-China summit planned for March 30–31 in Beijing, bringing Li together with the top EU leadership (European Commission President Ursula von der Leyen and European Council President Charles Michel). The summit will offer the first real opportunity to take stock of progress on commitments made in the ambitious joint declaration during the last summit in Brussels in April 2019. Immediately following the EU-China summit, there should also be the annual gathering of the 17+1 group in April 2020. However, many Central and Eastern European countries have become more apathetic about the format, concluding that China will keep overpromising and underdelivering on many of its investments. The fact that even the

[Czech President Miloš Zeman](#), who is generally considered one of Europe's most pro-China leaders, is reportedly considering to skip the summit is illustrative of this mood.

The most high-profile summit, however, will be the newly created EU27-China leaders' meeting in Leipzig, Germany, in September that is being organized under the auspices of the rotating German EU Council presidency. This unprecedented format is expected to be attended not only by Xi but by all twenty-seven EU leaders. Initiated by Merkel, the intention is to showcase European unity on China and to allow Xi to hear directly from all of Europe's leaders at once. The formal summit agenda is expected to cover three broad sets of issues: cooperation on a joint investment treaty, cooperation on development in third regions such as Africa, and climate change. The inclusive nature of the summit is indicative of Germany's approach in the EU and can be seen as a counterweight to both Macron's summit in Paris with German and EU officials and the 17+1 format. But some EU and member state officials have complained that Berlin controls too much of the agenda. In other quarters, there are also some concerns that the summit represents a power grab by Berlin and could signal a return to the pre-Lisbon Treaty days of conducting EU foreign policy when the rotating EU Council presidency was more in charge, as opposed to the EU institutions. The two key tests for the meeting will be whether the EU27 can maintain unity and whether it can deliver on the crucial question of the relationship with China. Should it waver, the summit could even end up being counterproductive for the EU's China policy by exposing intra-European divisions.

Tough Negotiations Over an Investment Treaty

The most important issue at the Leipzig summit is negotiations over a CAI. The stated goal is to complete these negotiations before the end of 2020. Although

progress has been made since 2018, a finalized agreement still seems quite remote before the summit. Negotiations are ongoing with the twenty-sixth round having just taken place after a second exchange of offers was made in December 2019. But on substance, EU officials are concerned Beijing is not progressing quickly enough and that political commitment to reach the finish line is lacking on the Chinese side. The new European Commissioner for Trade Phil Hogan has openly rejected the notion of an artificial timeline to reach agreement before the Leipzig summit, saying that “[substance should prevail over speed](#)” in the negotiations and that the EU is not ready to meet China halfway. Even so, some European officials have privately voiced concern that Berlin may be more willing to accept a compromise in order to ensure a successful summit deliverable. Merkel’s own governing coalition is weak, and she is keen to avoid a business turf war at home. To the outgoing German chancellor, the Leipzig meeting is seen as a chance to ensure that German businesses, who are struggling with a slowing economy at home and transatlantic trade tensions under Trump, will continue to have access to the increasingly important Chinese market.

Investment Screening Implementation and Tougher Export Controls

After completing landmark legislation in April 2019, the EU is currently preparing for the new EU screening mechanism to be activated in fall 2020. Even though the new mechanism will provide a more coordinated approach to the screening of FDI in the EU, member states will still retain a high degree of flexibility to make their own decisions. Over a handful of member states—including [Germany](#)—are currently reviewing existing legislation or thinking of introducing new legislation. A key question is whether the EU can learn to coordinate better on FDI screening both internally and with member states. There is also the need to increase cooperation with third countries. For example, the

EU is already engaging actively with the U.S. Treasury and the Japanese Ministry of International Trade and Industry on FDI screening. Privately, EU officials do not balk at the prospect of updating the screening legislation in the future should that be necessary. The new European Commission considers investment screening a top priority as part of an overall effort to strengthen European sovereignty.

While most of the EU’s focus so far has been on addressing inward FDI through investment screening, this needs to be complemented with greater attention paid to export control, an area where the EU currently plays a fairly limited role. The commission is revisiting the issue to see which regulations can be upgraded as the current framework does not go far enough to allow the EU to effectively address the issue. There is a need to recognize that one member state can constitute a security risk for other member states and the EU based on FDI or tech transfers. The EU is still far behind the Foreign Investment Risk Review Modernization Act legislations in the United States. The recent case of a [Dutch semiconductor](#) illustrates the importance of this issue in a European context. Because technology transfers encompass both the security dimension and the economic competitiveness dimension, it would be essential that any EU efforts also include attention to intangible assets such as know-how and intellectual property in these discussions.

Potential Chinese Backlash on 5G Decisions

In the next few months, many European governments are expected to be making crucial decisions on which supplier to award contracts to build out national 5G networks. While member states will retain decisions of 5G license and national security issues, the effort to promote a common European approach toward 5G security risks is noteworthy. On January 29, 2020, the commission released its [list of recommendations](#) of mitigating measures that member states could use.



While the EU toolbox does not single out a particular country or company, it does include both technical and nontechnical considerations. If employed by member states, the toolbox could provide a diplomatic cover for countries to de facto exclude or limit Huawei's role in building out 5G networks. This is an important consideration given Beijing's apparent willingness to resort to [intimidating language](#) and [threat of retaliation](#) against European countries considering rejecting Huawei. It is unlikely, however, that all European countries will make identical decisions. In the UK, despite pressures from the Trump administration to ban Huawei, British Prime Minister Boris Johnson's government has already committed to allow the Chinese firm to bid for [noncore parts of the British 5G market](#). As other countries are currently considering their options, the unfolding debates in [Germany](#) are particularly crucial in this regard, as they could provide a model for other, smaller countries to follow.

Potential Headway on Connectivity

China's BRI is today viewed with greater skepticism in Europe. In a January 2020 [report](#), the European Chamber of Commerce in China wrote that "the BRI has failed to become the open, transparent, and international initiative that it often claims to be as bidding processes are opaque and China's state-owned enterprises take the lead, and the bulk of the value, from BRI-related projects." The influential Beijing-based chamber added that its European members failed to gain any business from the initiative. Others, including some politicians in Southern or Eastern Europe, are calling for a clearer engagement from the EU on the BRI.

While the EU recognizes that China is adjusting its language, its main assessment is that the onus is on China to adjust its behavior, making the BRI

more sustainable. Throughout 2020, the EU will focus on further advancing its own connectivity strategy, including attempting to complete additional connectivity partnerships with external players (as the U.S. administration is keen to do before the next G7 summit in the United States in the summer) and appointing connectivity focal points at EU delegations around the world. The new EU leadership has signaled that it sees connectivity as one of the top priorities for the new European Commission. However, it is still unclear if the next multiannual financial framework (MFF) will include the significant funding levels for connectivity that the EU's strategy has called for. Once the next MFF is agreed upon, hopefully in 2020, the key will be for European connectivity officials to identify flagship infrastructure projects where the EU can make a tangible impact, especially in the Western Balkans.

Leveling the Economic Playing Field

The EU is losing patience with China's inability to deliver on market-based economic reforms. The EU is expected to take further action in 2020 in two key areas: procurement and subsidies. Having one of the world's largest open procurement markets, EU has long called for a more level playing field with China in the area of public procurement. The commission (backed by France) first called for the establishment of an EU [international procurement instrument \(IPI\)](#) in 2012 and presented a revised proposal in January 2016. The March 12, 2019, [strategic outlook](#) called for a "more strategic approach to the EU's procurement framework." This could include efforts to limit the access of foreign entities to the EU procurement market if these same countries discriminate against European companies. The commission is expected to call for an IPI to be adopted in 2020. Traditionally skeptical, Berlin has lately become more supportive of the idea.

The IPI is intended to increase the EU's bargaining to promote reciprocity, address protectionism, and provide new procurement opportunities for EU companies abroad. It symbolizes the EU's hardening approach and lack of patience with China's economic behavior. [China has responded](#) to potential EU clampdown, saying it could trigger a backlash against European companies. In Brussels, Europe's top corporate lobby association, Business Europe, recently published its own recommendations in a long-awaited [new report](#). It suggests four key objectives that the EU should pursue in order to seize the opportunities within the bilateral relationship while addressing the systemic challenges posed by China's state-led economic system. According to the report, the EU should secure a level playing field between China and the EU, mitigate the impact of China's government-induced market distortions, reinforce the EU's own competitiveness, and ensure fair competition and cooperation on third markets.

Moreover, addressing excessive state subsidies is another top priority for the new commission. The new European Commissioner for Competition [Margrethe Vestager](#) has said the EU is considering fresh efforts to curb unfair Chinese competition. A [Dutch proposal](#) from last year called for an overhaul of EU competition law to allow Brussels to block acquisitions of European companies from state-supported companies. It also called for greater transparency about foreign companies' operations. This follows a massive [increase in Chinese investments in Europe](#) in recent years. The main challenge for the EU is how to deal with state-driven subsidization of state-owned companies and subsidies of whole industries that are currently not regulated. The EU is looking for a more effective level playing field with state-driven economies. The EU is accordingly keen to engage China on the work of WTO reform and for China to also update its own rules on industrial subsidies. Finally, the EU has also engaged trilaterally

with the United States and Japan in the WTO, [agreeing in January 2020 on a proposal](#) for new trade rules to curb market-distorting subsidies following two years of discussions.

The Values Dimension

When it comes to human rights and democracy issues, the EU has historically had a certain margin of maneuver to put out critical statements because China preferred not to respond. For example, in response to the recent violence in Hong Kong, the European External Action Service has been fairly outspoken. Both Macron and Merkel have stressed the importance of human rights in their respective meetings with Chinese counterparts. However, over the past several months, Chinese diplomats have seemed increasingly bent at [pushing back](#) against rhetoric and policy decisions in Europe they disagree with, sometimes even resorting to threats or intimidation to get their point across. For example, in December 2019, the [Chinese foreign ministry denounced](#) the European Parliament's decision to award the Sakharov Prize for Freedom of Thought to Ilham Tohti, a Uighur activist. In another case, the Chinese ambassador to Sweden actively [criticized Swedish media and academics](#) for publishing content that the Chinese embassy disagreed with. As Chinese pressure on European countries continues and perhaps even intensifies in 2020, it will test European unity and solidarity among member states and collective willingness to push back against Beijing.

THE EU'S CHINA CHALLENGE IN 2020

The EU's newfound, more hard-nosed approach toward China is likely to set the tone for 2020. If anything, the new European leadership should be even more

determined to address challenges associated with China as the EU seeks to become more geopolitical and develop more sovereignty in a more competitive world. At the same time, the EU is keen to walk a fine line in its relationship with China in order to protect vital commercial interests. The new EU leadership—led by von der Leyen and High Representative Josep Borrell—is keen to deliver on the [EU's global role](#). The tougher EU line also allows weaker and more vulnerable member states to stay the course with China without facing retribution from Beijing. While it is welcome that the EU is beginning to develop a more realist view of international affairs and cultivating a more assertive role for Europe, leveraging the European Commission's geo-economic power, there is—more than ever—a need to foster a stronger, post-Brexit European political unity on China. As China likely intensifies pressure on Europe in 2020 fueled by the Phase One deal with the United States, ensuring Beijing is not able to continue to pick off individual European governments will be a key task.

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NOTES

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